



Canada-U.S. Relations

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Summary

Relations between the United States and Canada, though generally close, have undergone changes in tenor over the past three decades. During the 1980s, the two countries generally enjoyed very good relations. The early 1990s brought new governments to Ottawa and Washington, and although Canada's Liberal Party emphasized its determination to act independently of the United States when necessary, relations continued to be cordial. In early 2006, a minority Conservative government assumed power in Ottawa. It was regarded as being more philosophically in tune with the George W. Bush Administration than the Liberals were; some observers believe that this compatibility has helped facilitate bilateral cooperation. The election of President Obama November 2008 signaled a new chapter in U.S.-Canada relations; unlike President Bush, Obama is quite popular in Canada.

The two North American countries continue to cooperate widely in international security and political issues, both bilaterally and through numerous international organizations. Canada's foreign and defense policies are usually in harmony with those of the United States. Areas of contention are relatively few, but sometimes sharp, as was the case in policy toward Iraq. Since September 11, the United States and Canada have cooperated extensively on efforts to strengthen border security and to combat terrorism, particularly in Afghanistan.

The United States and Canada maintain the world's largest trading relationship, one that has been strengthened over the past two decades by the approval of two bilateral free trade agreements. Although commercial disputes may not be quite as prominent now as they have been in the past, the two countries in recent years have engaged in difficult negotiations over items in several trade sectors, including natural resources, agricultural commodities, and the cultural/entertainment industry. The most recent dispute has centered around the Buy America provision of the 2009 economic stimulus law. However, these disputes affect but a small percentage of the total goods and services exchanged. In recent years, energy has increasingly emerged as a key component of the trade relationship. In addition, the United States and Canada work together closely on environmental matters, including monitoring air quality and solid waste transfers, and protecting and maintaining the quality of border waterways.

Many Members of Congress follow U.S.-Canada environmental, trade, and transborder issues that affect their states and districts. In addition, because the countries are similar in many ways, lawmakers in both countries study solutions proposed in the other to such issues as federal fiscal policy and federal-provincial power sharing.

This report begins with a short overview of Canada's political scene, its economic conditions, and its recent security and foreign policy, focusing particularly on issues that may be relevant to U.S. policymakers. This country survey is followed by several summaries of current bilateral issues in the political, international security, trade, and environmental arenas. The questions following each summary are designed as potential inquiries to Canadian officials to promote thought and discussion among policymakers.

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Overview¹

Relations between the United States and Canada, though generally cordial, have undergone several changes in tenor over the past three decades. The 1980s and early 1990s were marked by an increasingly close partnership, whose milestones included the mid-1980s “Shamrock Summits” (named after the Irish heritage shared by the two countries’ leaders, Brian Mulroney and Ronald Reagan), the 1989 U.S.-Canada Free Trade Agreement, and the 1994 North American Free Trade Agreement. To many Canadians, however, Ottawa seemed at times to have drawn a bit *too* close to Washington, D.C., with Canada casting itself too willingly in a secondary role.

In 1994, one Canada watcher observed that in the foreign policy arena, Canada “politely distances itself from the United States” in certain ways. In an interview that year, the newly elected Liberal Prime Minister Jean Chrétien summed up his view of the bilateral relationship: “We like each other. I just don’t want Canada to be perceived as being the 51st state of America.” Many believe, however, that this initial show of mild reserve was intended for domestic consumption, and that Canada and the United States in fact continued to enjoy excellent relations. Chrétien and Clinton are said to have had congenial meetings; they focused on areas where the two countries were able to reach agreement, including environmental issues, cooperation on border measures and technology projects.²

In February 2001, President George W. Bush met with Chrétien. The two leaders discussed energy, missile defense, and trade. After September 11, however, economic and environmental issues often took a back seat to joint efforts to improve security, both at home and abroad. Canada became involved in the crisis at the outset, and has cooperated closely with the United States in efforts to combat international terrorism.

Nevertheless, Chrétien did not establish with President Bush the same rapport that he had enjoyed with Clinton. Differences over a number of issues tended to strain relations. The Bush Administration inherited some long-standing trade disputes, most notably over wheat and softwood lumber, and Canada and the United States were on different sides of several international issues, including the U.S. withdrawal from the ABM treaty and the International Criminal Court. But it was over security-related matters, particularly defense spending, Iraq, and missile defense, that the two governments had their sharpest differences. Notwithstanding these controversies, Canada and the United States have continued to work together on a number of fronts to thwart terrorism, including strengthening border security, sharing intelligence and expanding law enforcement cooperation. The Canadian government passed a new anti-terrorism act, and Canada has contributed significant military assets to the NATO-led coalition in Afghanistan.

Paul Martin, who became prime minister in December 2003, met several times with President Bush. At the January 2004 Summit of the Americas, the two leaders discussed several topics and came to agreement on Canadian eligibility to bid on reconstruction contracts in Iraq and on the ground rules for U.S. deportation of Canadian citizens. In April 2004 in Washington, D.C., Martin

¹ Prepared by Carl Ek, Specialist in International Relations; and Ian F. Fergusson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

² “Canada Narrows Its Foreign Policy Goals to Focus on Trade.” By Charles Trueheart. *Washington Post*. November 17, 1994. p. A44. “Don’t Take Canada For Granted.” By Tad Szulc. *Parade Magazine*. February 20, 1994.

and Bush met once more and talked about a variety of issues, from terrorism to the “mad cow” crisis. In November 2004, during President Bush’s first official visit to Canada, missile defense, border security, and global “hot spots” were on the agenda. Although bilateral tensions heated up in 2005 over the issues of missile defense and softwood lumber, Canada’s government and private citizens responded promptly and generously to assist the United States after hurricane Katrina.³

In February 2006, after a come-from-behind election victory, the Conservative Party assumed power as a minority government, and Stephen Harper became Canada’s 22nd Prime Minister, the first Conservative to lead the country in 12 years. Observers believed that Harper’s government was somewhat more politically compatible with the Bush Administration in many areas. However, although the policy orientation of Harper’s Conservatives may be similar to that of the Republicans in Washington, differences still arose on certain issues, particularly those that touch upon matters of perceived sovereignty. For example, on January 26, 2006, days before his inauguration, Harper sharply took exception to comments made earlier by U.S. Ambassador to Canada David Wilkins and asserted Canada’s sovereignty over the so-called Northwest Passage, the frozen arctic region that global warming may turn into a waterway linking Asia and Europe.⁴

The election of Barack Obama in November 2008 signaled a new chapter in U.S.-Canada relations. Unlike President Bush, Obama has been quite popular in Canada – a January 2009 public opinion poll put the new American president’s approval rating in Canada at 86%. Some believe that this favorable view may be facilitating the Harper government’s cooperative efforts with the United States. In addition, although Harper has a somewhat more conservative orientation than Obama, both leaders are pragmatic in their approach to solving public policy problems, and observers believe the bilateral relationship will continue to be collaborative and productive. On February 19, 2009, renewing a tradition broken in 2001 by President Bush, Obama made Canada his first official foreign visit. He and Harper focused on trade, climate change, and Afghanistan, among other issues; in September 2009, Harper met with Obama at the White House. Polls conducted in September 2009 and January 2010 showed that Obama enjoyed continued popularity among Canadians.⁵

Canada’s Domestic Scene

Background and Current Political Situation

The Liberal Party, in power since 1993, was by 2003 being commonly referred to as “Canada’s natural ruling party.”⁶ Maintaining a Liberal majority appeared to be a safe bet at that time, but in February 2004 the “sponsorship scandal” erupted. Canada’s Auditor General issued a report stating that, under a program intended to build support for Canadian unity, the Chrétien

³ “Bush Launches Bid To Repair US-Canada Ties.” *Agence France-Presse*. November 30, 2004.

⁴ “Harper Tells U.S. To Butt Out On Plans For Defending Canada’s Arctic.” *The Canadian Press*. January 26, 2006.

⁵ “Obama Makes Overtures to Canada Prime Minister.” *New York Times*. February 20, 2009. “Obama’s Popularity Higher Than Ever In Canada: Poll.” *National Post*. September 20, 2009. “U.S. President Still Rocks Canada.” *Toronto Star*. January 28, 2010.

⁶ “Welcome to Their Nightmare: Finally, a Reason To Start Paying Attention To Politics Once Again.” *Globe and Mail*. December 8, 2003.

government had funneled C\$100 million in public funds for dubious contracts to Québec advertising firms associated with the Liberal party.⁷

The Liberals' standing in the polls plummeted, and the opposition strengthened. To the right of the Liberals, two conservative parties had merged under a new leader, Albertan Stephen Harper. And to the left, the New Democratic Party (NDP) likewise had recently elected a dynamic party chief, Jack Layton.

In June 2004 elections, the Liberals, despite losing seats in the House of Commons, won a plurality and formed a minority government. In November 2005, the Liberals lost a confidence vote, and snap elections were held on January 23, 2006. This time, the Conservatives won a plurality, and have been governing since then as a minority. Some analysts cautioned that the Tory victory did not necessarily represent a "paradigm shift" to the right in Canadian politics; they noted that the Conservative party won only 37% of the popular vote. Because past minority governments have been relatively short-lived, Harper has been keeping one eye on the next elections. In addition, Harper has relied upon the *ad hoc* support of the other three parties to ensure passage of the various items on his legislative agenda. Many believe that is why he has advocated fairly centrist policies.⁸

However, Harper has been willing to challenge public opinion over Afghanistan, where the Liberal government deployed troops in 2002. In 2006, he won a narrow vote in parliament to keep Canadian troops in Afghanistan for two additional years. Harper initially characterized the mission as humanitarian in nature and also asserted that it was in Canada's national interest to demonstrate its ability to play a leadership role internationally. But as Canadian operations shifted from peacekeeping to counter-insurgency, public support diminished. Canadian troops are now scheduled to be pulled out by the end of 2011.

Canada's most recent elections, held on October 14, 2008, did little to change the makeup of parliament. The Conservatives, who reportedly anticipated a weakening in future support, called the elections in hopes of capturing a majority. However, the Tories emerged only with a somewhat stronger plurality – still short of a majority. Of the 308 seats in parliament, the Conservatives currently hold 144, the Liberals 77, the BQ 48, and the NDP 37, with two independents.⁹ Canada has now had three minority governments in a row.

In November 2008, a budget bill put forward by the Conservatives precipitated a political crisis; the spending plan proposed, among other things, the elimination of federal funding for political parties. The opposition parties, which would have been severely affected by the plan, rebelled and were poised to vote down the government – ostensibly because Harper had failed to put forward a stimulus package that would respond to the economic downturn. Harper withdrew his proposals and, to avoid the no-confidence motion, prorogued (suspended or recessed) the session of parliament until January 2009; the shutdown was sharply criticized by many.¹⁰

⁷ "Canada: Martin on the Ropes in Funding Scandal." *Oxford Analytica*. February 25, 2004. February 23, 2004. "Canada's Premier Acts to Counter Scandal." By DeNeen L. Brown. *Washington Post*. February 17, 2004.

⁸ "Interview: Stephen Harper." *Maclean's*. March 6, 2006. "Conservatives To Govern From Political Center." *Oxford Analytica*. January 24, 2006. "Harper's Five Easy Pieces." *Economist*. April 8, 2006.

⁹ Canada: An Early Appointment With Electoral Destiny. *The Economist*. September 6, 2008. Canadian Parliament's website, updated April 9, 2010: <http://www.parl.gc.ca/information/about/process/house/partystandings/standings-e.htm>

¹⁰ "Canadian Leader Shuts Parliament To Avoid No-Confidence Vote, Angering Many." *New York Times*. December 6, (continued...)

During this time, the Liberal party named public intellectual Michael Ignatieff as their new leader. Some believed that when Parliament returned in January, he would seek to bring down the government and force new elections. However, he declined to do so, reportedly choosing instead to support the government's stimulus program (see below) and to consolidate the party's strength rather than challenge the Conservatives immediately.

In the fall of 2009, many believed the Harper government might face a no-confidence vote, particularly when public criticism was touched off by questions over how forthcoming the government had been during inquiries over official knowledge about the turnover by the Canadian military to Afghan authorities of prisoners who were subsequently tortured (see below). On December 30, 2009, Harper prorogued parliament until early March. Harper's spokesperson explained the move as one necessary to give the government the time to "recalibrate" and "consult" over its budgetary policies and the upcoming Throne Speech – similar to the State of the Union speech in the United States. However, other observers argued that Harper sent the legislature home in order to avoid confrontation over the detainee controversy. The second prorogation in roughly a year's time prompted harsh criticism by the opposition parties, as well as scattered protests around the country.

However, an uptick in the economy has helped Harper, whose party also benefited from a "bounce" from the success of the Vancouver Winter Olympics. In addition, the government's handling of aid to Haiti in the wake of the January 2010 earthquake earned praise. On the negative side of the ledger, Harper has been faulted for two seemingly unnecessary prorogations, and also for not carrying out the institutional changes (including reform of the Senate and of the electoral process) that he promised during his late 2005 campaign and early in his tenure.

On balance, the political intermission appears to have benefited the Conservatives, who have enjoyed a surge in the polls. In addition, Canadians view Harper as more suitable for the Prime Minister's post than Ignatieff, who has failed to gain traction. An April 2010 Ipsos Ried survey gave the Tories a ten-point lead, still shy of the 40% approval rating deemed necessary to win a majority of seats in parliament. Analysts are now speculating that Harper's minority government may serve out its full term. The Liberals, it is believed, are unlikely to provoke a no-confidence vote unless polls show them to be within striking distance of winning a majority. In addition, many argue that Canadians are weary of elections; at 59.1%, turnout for the last vote was the lowest in history. Voter participation may therefore play a key role in the next election.¹¹

National Unity

For four decades, an emotional debate has raged over the status of French-speaking Québec, Canada's second largest province geographically and home to about one-quarter of its population.

(...continued)

2008. "The Liberals Try a New Leader." *The Economist*. December 13, 2008.

¹¹ "Harper Goes Prorogue." *The Economist*. January 9, 2010. "Improved Poll Numbers Not Enough To Entice Ignatieff Into Spring Election." *Canadian Press*. January 28, 2010. "Conservatives Secure 10-Point Lead: Poll." *National Post*. April 12, 2010. "Stalled Institutional Reform Hurts Harper." *Oxford Analytica*. March 9, 2010. "Stimulus Has Boosted Growth, Harper." *Oxford Analytica*. April 14, 2010. Canada Politics: Speculation About Election Ebbs. *EIU Viewswire*. April 19, 2010.

Many Québécois are concerned that their language and culture will be overwhelmed by the rest of English-speaking Canada. Some believe that their society may only be preserved if Québec separates from the rest of Canada and forms an independent country. A 1980 referendum on “sovereignty-association” for Québec was defeated 60%-40%.

In October 1994 elections, after the provincial Liberals had governed Québec for several years, the province once more elected the separatist Parti Québécois (PQ). The victorious PQ held a referendum on sovereignty on October 30, 1995. Québeckers essentially voted on whether they wished to continue to remain a part of Canada, or strike off on their own. The vote went 50.6% to 49.4% in favor of keeping the country whole. The wafer-thin margin shocked federalists and separatists alike. More than a decade later, the country is still affected by the impact of what has been called a “near-death experience.”

In 2003, Québec voters turned out the PQ and replaced them with the Liberals, led by Jean Charest. A former leader of the Progressive Conservatives at the national level, Charest is a committed federalist, which rules out another sovereignty referendum during his tenure. In the early part of his first term, Charest lost popularity when he attempted to reduce the economic role of the provincial government; those efforts prompted strong protests from the powerful public service unions. Some Québec-watchers assert that Charest learned from this experience and changed his tactics. In elections held in 2007 and 2008, the Liberals won a plurality, and a majority, respectively; Charest has retained his spot as premier.

Since the debate began in the 1960s, the United States government has assiduously sought to remain officially neutral on the issue of Québec, continually repeating the three-point “mantra” that the United States enjoys excellent relations with a strong and united Canada; that the Québec question is an internal issue that is for Canadians to decide; and that the United States does not wish to interfere with Canada’s domestic matters. However, some analysts detected a slight “tilt” on the part of Clinton Administration toward the federalists during the 1995 referendum campaign. If, at some future date, Québec eventually *does* leave the confederation, the U.S. government will be faced with difficult political and economic questions.

Foreign and Security Policy Issues

As a middle power, Canada has exercised a somewhat disproportionate influence in world affairs, chiefly through its active participation in international organizations, including the G-8, and the Asia-Pacific Economic Cooperation forum. From 1998-2006, Canadian diplomat Louise Frechette served as Deputy Secretary General of the United Nations, and from 1996-2006 Canadian Donald Johnston was Secretary General of the Organization for Economic Cooperation and Development. The president of the International Criminal Court from 2003-2009 was Judge Philippe Kirsch from Canada. The first head of the U.N. War Crimes Tribunal was Canadian Louise Arbour. In June 2005, Canadian Air Force General Ray Henault was named head of NATO’s military committee, a post he held until 2008.

Canadians are proud of the active role played by their military as international peacekeepers. Since the United Nations first dispatched an armed peacekeeping contingent to help defuse the Suez Crisis in 1956, Canada has participated in nearly every U.N. peacekeeping operation, from Cyprus and the Sinai, to Bosnia, Rwanda, Somalia, and Afghanistan. As of April 2010, over 2,900

Canadian Forces personnel were participating in international operations in Afghanistan, the Middle East, and Africa.¹²

As with other countries in the 1990s, Canada's military was subject to dual pressures. In Ottawa's view, the collapse of the Soviet Union and the Warsaw Pact reduced the military threat, making it more difficult for the government to justify sustaining historic spending levels on defense. Leaders believed that the country's large debt early in the decade necessitated funding cutbacks in most areas of government, including defense. However, relative to its NATO allies, Canada had devoted only a modest share, about 2% of GDP, of its budget to defense spending during the 1980s and 1990s. That percentage declined even further, from 2.01% in 1990 to 1.1% in 2005; among the 26 NATO members, only Luxembourg and Iceland (which has no armed forces) spent a lower percentage. Canada's meager military budget irked some within the alliance, particularly the United States.¹³

After the round of cutbacks in the 1990s, the number of active personnel in Canada's armed forces tumbled from 87,000 in 1989 to 52,000 in 2004, the 56th largest in the world. The Canadian forces also were strapped for resources to replace aging equipment. This trend disturbed many, and there were numerous warnings published. In March 2002, a Canadian Senate committee called for increased defense spending to counter the threat of international terrorism; it also recommended that personnel levels be increased and that more resources be provided to the Canadian Security Intelligence Service. A November 2002 Senate report recommended boosting troop levels to 75,000 and restructuring the armed forces. A brace of studies in the fall of 2003 likewise called for changes in force restructure and procurement practices and for increases in manpower and budgets. A news report characterized one of the studies as concluding that "Canadian Forces are teetering on the edge of irrelevance." In September 2005 the Senate published yet another report, which called for a doubling of spending on defense.¹⁴

Recent Canadian governments appear to have heeded these messages. As of April 2010, there were approximately 66,000 regular force members and 34,000 reserves. In addition, Canada's defense spending has been trending upward. The budget tabled in February 2005 contained the largest military spending increase in two decades: C\$12.8 billion—roughly equal to the entire 2005 military budget—spread over five years. The Harper government's first budget added C\$5.4 billion in military spending over the next four years. The 2007 budget confirmed the previous year's spending increase, and the 2008 budget seeks to ensure continuity through the Canada First Defence Strategy, which will provide for yearly increases of 2% beginning in 2011-12. The government budget for the armed forces in 2008-2012 will average around C\$20 billion annually.¹⁵

¹² *Canada and International Peacekeeping*. By Joseph T. Jockel. Center for Strategic and International Studies/Canadian Institute of Strategic Studies. Washington, DC, 1994. Current Operations. Canadian Expeditionary Force Command website. Updated April 14, 2010. <http://www.cefcom.forces.gc.ca/pa-ap/ops/index-eng.asp>

¹³ "Spend More On Military, U.S. Envoy Urges Ottawa." *Toronto Star*. February 25, 2004.

¹⁴ "Armed Forces Hobbled, Report Says." By Daniel LeBlanc. *Globe and Mail*. December 3, 2003. "Senators Sounding Alarm On Defence." *The Gazette*. October 3, 2005.

¹⁵ *The Military Balance, 2010*. International Institute for Strategic Studies. Defence and Budget 2005—Highlights. DND website. http://www.forces.gc.ca/site/reports/budget05/summ05_e.asp.

U.S.-Canada Security and Foreign Policy Issues

According to the U.S. State Department, “U.S. defense arrangements with Canada are more extensive than with any other country.” Former Canadian Ambassador Michael Kergin referred to the defense relationship as being “intermestic” in nature.¹⁶

Over the past century, U.S.-Canadian defense cooperation has been close. In 1940, President Franklin D. Roosevelt and Prime Minister McKenzie King established the Permanent Joint Board on Defense, which formalized bilateral consultation on military matters and is still in operation. In 1949, the two countries were founding members of NATO. During peacetime, military cooperation has occurred chiefly in the context of bi- and multinational organizations.

NORAD

In 1958, Canada and the United States signed the North American Aerospace Defense Command (NORAD) agreement. The continental air defense pact monitors U.S. and Canadian airspace and encourages joint efforts in aerospace technologies. In the wake of the September 11 terrorist attacks, there were discussions of deepening military cooperation along the NORAD model, in the context of the newly created U.S. Northern Command, to include land and sea forces. But some Canadians were concerned that such a move might impinge upon Canada’s sovereignty, and in August 2002, the Canadian government announced that its land and sea forces would not be participating in the command. In December 2002, however, the two countries signed a new accord creating a binational planning group (BPG) based at NORAD to coordinate responses to terrorist attacks and other crises. The BPG issued its final report in March 2006; the panel put forward numerous recommendations, including that the two countries develop a common security vision and improve interoperability through joint military planning, training, exercises, and information sharing. In August 2004, Canada and the United States amended NORAD to permit it to share information on incoming ballistic missiles. Ottawa and Washington also agreed to expand the scope of the agreement to encompass nautical surveillance.

On February 14, 2008, the commanding generals of U.S. Northern Command and of its Canadian counterpart, Canada Command, signed a binational Civil Assistance Plan. Under the plan, the armed forces of each country, after appropriate consultation with civilian authorities on both sides of the border, may come to the support of the other country’s military in the event of civil emergencies such as floods, earthquakes, or the effects of a terrorist attack. In November 2009, NORAD launched a review of possible threats and of binational air defense capabilities.¹⁷

¹⁶ United States Department of State. Bureau of Western Hemisphere Affairs. *Background Note: Canada*. February 2010. “Remarks to the Center for Strategic and International Studies.” February 28, 2005.

¹⁷ “Continental Divides.” By Sydney J. Freedberg, Jr. *National Journal*. March 23, 2002. “Leading academics Examine Risks Inherent In Closer Military Co-operation With the United States.” *Canada NewsWire*. April 26, 2002. “Canada Won’t Join Norad-Like Land-Sea Force. By Rick Mofina.” *Ottawa Citizen*. August 15, 2002. September 12, 2005. Binational Planning Group. Final Report. March 13, 2006. <http://www.canadianally.com/BPGFinalReport.pdf> U.S. Northern Command website: <http://www.northcom.mil/news/2008/021408.html> Canada, U.S. Set To Review Air Defence Capabilities. *Ottawa Citizen*. November 26, 2009.

Missile Defense

Ottawa long debated whether it should participate in the U.S. missile defense (MD) system. Some analysts expressed reservations over the plan, in the belief that it might spark a new arms race, while others reportedly preferred to keep Canada's options open. Parliament held hearings on the issue, but no official policy was enunciated. Finally, in May 2003, Canada said that it would enter into discussions with the United States; a Canadian military affairs journalist described Canada's likely negotiating goals: "Canada wants the anti-missile shield run by NORAD—in effect, giving Canada equal status in protecting North America and a finger on the trigger. Ottawa wants a share of the industrial benefits and access to secret technologies, all while paying little or nothing. And it continues to insist that space not be weaponized."¹⁸

On February 24, 2005, the Canadian government said that it would not participate in MD. However, Canada's ambassador to the United States had pointed out earlier that the two countries had already agreed to allow NORAD to share information with U.S. MD commands. U.S. officials expressed puzzlement and disappointment with the announcement, noting that Canada had sent signals that it would likely sign on. Polls showed that a majority of Canadians, particularly Québeckers, opposed MD, leading some analysts to suggest that domestic political pressures may have guided the decision. In late February 2006, Canada's Defense Minister said that the Harper government likely would review the missile defense issue if asked to do so by Washington. Any final decision on participation, he added, would be subject to a parliamentary vote. In April 2008, U.S. General Gene Renuart, head of NORAD, was quoted as having said that all incoming intelligence concerning missile threats was shared with Canada.¹⁹

Joint Strike Fighter

In February 2002, Canada agreed to participate in the further development of the U.S.-led multinational Joint Strike Fighter program, contributing \$150 million over a 10-year period. In December 2006, it was announced that the Canadian government had committed an additional C\$500 million for the development of the aircraft. Canada has reportedly agreed to consider the purchase 80 of the new fighters to replace its own fleet of CF-18 planes when they are retired in 2017, and has earmarked nearly C\$4 billion for the new planes. In June 2007, the Department of National Defense announced plans to form a new office to evaluate Canada's future air defense requirements. Canada appears to be reaping rewards from its participation; as of June 2007, Canadian firms had won 150 JSF contracts worth about \$160 million. In addition, Canadian defense companies stand to benefit from the Pentagon's plans to purchase additional F-35s. In November 2009, it was reported that if Canada purchased the aircraft, the United States would not permit access to the software codes for controlling the planes' weapons, radar, and flight systems.²⁰

¹⁸ "Shoot Down Defence Dreamers." By Paul Koring. *Globe and Mail*. June 25, 2003.

¹⁹ "Canada and the U.S. Missile Defense System." Dwight M. Mason. *CSIS Hemisphere Focus*. January 9, 2004. "Martin and the Politics of Missile Defense." *Globe and Mail*. May 1, 2004. "Missile Defence Won't Work." *Ottawa Citizen*. December 15, 2004. "Martin's Move Irritates U.S." By Sean Gordon. *Toronto Star*. February 24, 2005. "Minister Backs U.S. Missile Plan." *Toronto Star*. February 24, 2006. "Canada Kept In Loop At NORAD About All Missile Threats." *Ottawa Citizen*. April 10, 2008.

²⁰ "Canadian Firms Big Winners In U.S. Jet Project." *National Post*. April 21, 2006. "Canada Commits Up To \$500 Million to the Development of CF-18 Replacement." *The Canadian Press*. December 13, 2006. "New Office To Assess Canada's Fighter Needs." *Defense News*. June 18, 2007. Forces Tag \$3.8B To Buy Advanced Jets. *Ottawa Citizen*. (continued...)

NATO

Canada has been engaged in the debate over NATO's future. It supported the 1999 and 2004 rounds of enlargement and has announced that it will participate in the NATO Response Force, which the alliance agreed to at its November 2002 Prague summit. At the April 2008 Bucharest summit, Canada endorsed the addition of Croatia, Albania, and Macedonia; in addition it supported the proposal to offer Membership Action Plans to Georgia and Ukraine. Finally, as noted above, Ottawa has maintained troops in Afghanistan since 2002, and its military leaders have served in a command capacity. In April 2003, then Foreign Minister Graham, along with the Dutch and German governments, requested that NATO take over command of ISAF.²¹ In a 2009 speech in the UK, Canadian Defense Minister Peter MacKay cautioned that NATO was being tested in the crucible of Afghanistan, and urged more equitable burden sharing.²²

Although it has no troops stationed in NATO territory in Europe, Canada in recent years contributed several hundred troops to the NATO-led Stabilization Force (SFOR) in the Balkans. Canada also supplied 200 troops to NATO's mission in Macedonia. Canada cooperated "wing-to-wing" with the United States in *Operation Allied Force*, the NATO campaign of air strikes against targets in Serbia and Kosovo, contributing 18 CF-18 fighter aircraft and providing two rotations of approximately 1,500 troops each to KFOR. In addition Canada has supported non-NATO peacekeeping operations; it has provided 600 to the initial U.N. peacekeeping mission in East Timor and has also contributed 500 troops to maintain stability in Haiti.²³

Afghanistan

Canada was one of the first countries to join the military operation in Afghanistan; its participation dates back to October, 2001. Along with British, Dutch, Danish and U.S. troops, Canadian forces have been serving on the front line in the combat operations to counter attacks by al Qaeda and Taliban fighters. Canada has been maintaining approximately 2,800 troops in the country. A total of 142 Canadians, including one diplomat, have died in Afghanistan. In 2005, Canada launched a Provincial Reconstruction Team mission in Kandahar. Ottawa also has provided humanitarian and reconstruction assistance to Afghanistan. Canada is among the top five donors to the country, and has pledged C\$1.9 billion through 2011 in reconstruction and development assistance.²⁴ As noted above, Canada intends to remove its troops by 2011.

(...continued)

June 27, 2007. Canada To Gain From U.S. Defense Budget. *National Post*. April 8, 2009. U.S. Denies Canada Info Needed To Maintain Jets. *Ottawa Citizen*. November 25, 2009.

²¹ "NATO Umbrella Sought." By Allan Thompson. *Toronto Star*. April 4, 2003. "NATO Sees Key Role For Canada In Afghan Security." *Reuters*. May 6, 2003. CRS interview of Canadian government official, May 7, 2008.

²² NATO's Future At Stake In Afghanistan: MacKay. *Ottawa Citizen*. February 16, 2009.

²³ Current Operations. Canadian Expeditionary Force Command website. Updated April, 2009. <http://www.comfec-ecfcom.forces.gc.ca/pa-ap/ops/index-eng.asp>

²⁴ DND website: http://www.forces.gc.ca/site/newsroom/view_news_e.asp?id=1703. "Canadian Development Assistance In Afghanistan: Current Projects." Government of Canada website. January 31, 2008. http://www.canada-afghanistan.gc.ca/cip-pic/afghanistan/library/afgh_security-en.asp

Haiti

Canada and the United States have worked closely together over the past sixteen years with the U.N. mission in Haiti, where a contingent of the Canadian armed forces, along with members of the Royal Canadian Mounted Police, took the reins from departing U.S. forces who had helped restore the democratically elected government in Haiti in 1994. In 2004, after the Aristide government stepped down in the face of armed rebellion, Canada joined the United States and France in providing peacekeepers to the U.N.-authorized Multinational Interim Force sent to the troubled island; Canada dispatched helicopters and nearly 500 troops. In February 2008, Canadian Foreign Minister Bernier traveled to the island nation, where he announced that Ottawa's total multiyear aid package would be raised to C\$555 million. In the wake of the turmoil over food shortages, he called for international donors to harmonize their assistance during an April 2008 donor conference. Haiti is the second-largest recipient (after Afghanistan) of Canadian development assistance. Canada's Governor General, Michaëlle Jean, who was born in Haiti, traveled to the island in January 2009; she visited several development projects, and met with government and civil society leaders. Jean returned to visit following the January 12, 2010 earthquake that devastated the country. At an international donor conference held at the United Nations on March 31, Canada made a two-year pledge of C\$400 million in humanitarian and reconstruction assistance, making it the largest per capita provider of aid to Haiti.²⁵

Iraq

Canada was disinclined to expand the so-called war on terrorism beyond Afghanistan to Iraq. In September 2002, during a meeting in Detroit with President Bush, Chrétien reaffirmed Canada's preference for a U.N. mandate, a stance that strongly reflected Canadian public opinion. Washington later requested of Ottawa specific military commitments in the event of a conflict with Iraq, but no definitive answer was given. Over the following months, the government's statements on Iraq were characterized by the media as imprecise and at times contradictory, an apparent attempt to keep options open. But in the House of Commons on March 18 2003, Chrétien stated unequivocally that "Canada will not participate." The Bush Administration expressed disappointment with the Canadian government's decision.²⁶

Washington subsequently requested that Canada assist in the reconstruction of Iraq by sending troops or military police. Ottawa responded by offering 150 members of its Disaster Assistance Response Team, a non-traditional military unit consisting of security, engineering, and medical personnel. Canada also provided funding in a number of areas, including humanitarian and reconstruction aid, support for elections, and police training. The Canadian International Development Agency pledged C\$300 million (2003-2010) in assistance to Iraq. In January 2004, Canada announced that it would cancel Iraq's \$564 million debt.²⁷

²⁵ "Canada Pledges \$555 Million In Aid To Haiti." *Reuters*. February 24, 2008. Canada Participates In Harmonization Efforts In Haiti. News Release. Foreign Affairs and International Trade Canada. April 23, 2008. 'I Can Feel the Strength of the People,' Jean Says. *National Post*. March 30, 2010. Canada Pledges \$400 million To Haiti. *Ottawa Citizen*. April 1, 2010. Canada's Role In Haiti. *Globe and Mail*. April 3, 2010.

²⁶ "Well, Maybe" *Economist*. September 28, 2002. "PM Scolds McCallum On Canada's Role In Iraq." By Shawn McCarthy and Daniel Leblanc. *Globe and Mail*. January 16, 2003. "Bravos Greet Chrétien." By Tim Harper. *Toronto Star*. March 18, 2003.

²⁷ "Iraq: Canada's Commitment." Canadian International Development Agency web page: <http://www.acdi-cida.gc.ca/iraq#1> Updated May 24, 2007.

Cuba

Cuba has been another issue where the two countries have not always seen eye-to-eye. For decades, Canada has maintained normal diplomatic relations with Cuba, and has maintained relatively extensive business links: Canada is Cuba's third-largest trading partner and its number one source of tourists. Because of this ongoing commercial relationship, Canadian government officials publicly criticized a U.S. law (the Cuban Liberty and Democratic Solidarity Act, P.L. 104-114) that seeks to apply indirect pressure on the Castro regime by permitting Cuban-Americans to file lawsuits against foreign firms that use Cuban property that was expropriated by the Castro regime. U.S. supporters of the Cuba embargo have been critical of Canadian mining companies and hotel chains that do business with the island nation. Canadians, who are sensitive to being perceived as America's "junior partner," object that the law amounts to the United States forcing its foreign and commercial policies upon other countries. In 2003, after the Castro government handed down Draconian prison terms to 75 political dissidents, Ottawa expressed official disapproval. The transfer of Cuba's presidency from Fidel to Raul (temporary in 2006, permanent in 2008) prompted vigorous debate in the Canadian press over what policy Ottawa should adopt toward Cuba.²⁸ In April 2009, the Obama Administration announced that it would ease restrictions on family travel and remittances to Cuba and allow greater telecommunications links with Cuba. The decision was welcomed by Ottawa; Peter Kent, Minister of State of Foreign Affairs for the Americas, commented that "the election of the Obama Administration has given real momentum to the sort of change that Canada has been encouraging for a long time." A planned trip by Kent to Havana in May 2009 was cancelled, reportedly because Kent had said that he planned to address the human rights issue during his trip, and because Prime Minister Harper had referred to himself as an "anti-communist conservative." The trip was re-scheduled, and Kent traveled to Cuba later in the year.²⁹

International Criminal Court

The International Criminal Court (ICC) is another issue on which the two countries differ. Canada has long been a leading advocate of the U.N.-sponsored tribunal, while some U.S. policymakers have opposed U.S. participation on the grounds that it might make U.S. military personnel vulnerable to politically motivated prosecution by hostile regimes. In May 2002, the Bush Administration declared that the United States would not support the ICC; the same day, Canadian Foreign Minister Bill Graham declared that he was "extremely disappointed" with the U.S. decision. In a U.N. speech four months later, Graham faulted the United States "for its 'ad hoc and unilateral pursuit' of the prosecution of crimes against humanity."³⁰

²⁸ See, for example: "Castro's Resignation Unlikely To Change Canadian-Cuban Relations, Experts Say." *The Canadian Press*. February 19, 2008. "Don't Support Castro's Island Prison." *National Post*. February 19, 2008. "With Fidel Castro Gone, U.S. Hawks Will Look North." *Toronto Star*. February 20, 2008. "The Autumn Of the Patriarch." *Ottawa Citizen*. February 23, 2008.

²⁹ CRS Report R40153, *The First-Time Homebuyer Tax Credit: An Economic Analysis*, by Mark P. Keightley. "Unreformed Tyranny." *Globe and Mail*. November 23, 2009. "Cuba To Give Canada Expanded Air Access With Island To Boost Tourism." *The Canadian Press*. January 15, 2010.

³⁰ "Canada Raps U.S. Rejection Of World Criminal Court." By David Ljunggren. *Reuters*. May 6, 2002. "U.S. Rift With Allies On World Court Widens." By Julia Preston. *New York Times*. September 10, 2002.

Border Security

In the wake of the attacks on New York and Washington, U.S.-Canadian relations came to the fore. In particular, the issue of U.S.-Canada border security was brought into sharp focus. The issue first became a matter of urgent concern in December 1999, when U.S. border officials, acting on a tip from Canadian authorities, stopped Ahmed Ressam at the U.S.-Canadian border as he was attempting to smuggle explosives into the United States; it was later discovered that Ressam had planned to bomb the Los Angeles airport, and that he had received terrorist training from Al-Qaeda in Afghanistan.

Despite the fact that none of the 19 September 11 hijackers entered from Canada, the attacks sparked renewed debate over Canadian laws regarding the treatment of immigrants seeking refugee status or political asylum.³¹ By February 2002, Ottawa had already made “steps to tighten immigration and refugee policies, including more rigorous screening of people who claim refugee status and stepped up detentions and deportations of claimants suspected of being security risks.”³²

Some American policymakers pointed to the Ressam case as proof that the United States must tighten its borders with Canada. Skeptics, however, note that such measures might seriously impede commerce by creating long delays at border crossings, and that determined terrorists and criminals would at best be inconvenienced, not stopped, in traversing the two countries’ 5,500-mile border. About 70% of U.S.-Canada merchandise trade crosses the border by truck; many of these shipments are “just-in-time” deliveries; their delay at border crossings can seriously disrupt manufacturing in the United States and Canada.³³ Both sides have strong incentives to strengthen security but keep goods flowing.

Since the September 11, 2001, attacks, Ottawa and Washington have taken numerous steps, separately and jointly, to improve border control. In December 2001, they signed the Smart Border declaration that aims at improving security and efficiency at border crossings; the agreement lays out a 30-point (since increased to 32-point) list of areas of joint activity, ranging from pre-clearance of goods (the FAST program) and people (NEXUS), to biometric identifiers, to infrastructure improvements. The cooperation covers crossings by air, land, and sea traffic. In December 2002, the two nations signed the Safe Third Country agreement, intended to permit coordination of refugee and asylum policy.

The Western Hemisphere Travel Initiative (WHTI), a provision of a 2004 U.S. law requiring travelers passing between the two countries to present a passport, a NEXUS card, or an equivalent secure, approved document, at the border came into effect on June 1, 2009. The Department of Homeland Security (DHS) has been working with the Canadian government to develop an alternative document that is secure, inexpensive, and would be carried anyway—for example, a driver’s license containing enhanced biometric information. Currently, such enhanced licenses are being issued by the provinces of British Columbia, Manitoba, Ontario, and Québec, and by the states of Michigan, New York, Vermont, and Washington. Although comprehensive

³¹ In April 2009, U.S. Department of Homeland Security Secretary Janet Napolitano raised concerns when she averred that some of the 9/11 terrorists had crossed over from Canada. “Napolitano’s Comments About Canada’s Border Spark Diplomatic Kerfuffle.” *The Canadian Press*. April 21, 2009.

³² “Al-Qaida In Canada?” CBSNEWS.com. April 25, 2002. “Canada Alters Security Policy To Ease Concerns of U.S.” By Clifford Krauss. *New York Times*. February 18, 2002.

³³ “Delays at the Canadian Border Eat Up Trade.” By John Stark. *AP*. February 1, 2003.

travel data for 2009 is not yet available, anecdotally, single-day trips by U.S. residents to Canada appear to be the most adversely affected by the new regulations.³⁴

Canada's custom service stepped up the purchase of high-tech X-ray equipment, and U.S. and Canadian customs agents are working together, inspecting containers at several Canadian and U.S. seaports. Border security personnel levels have also been beefed up, and Integrated Border Enforcement Teams have been established in high-priority regions. Canada also has set up an Air Transport Security Authority, which, among other activities, is responsible for pre-board screening.

In 2004, the Canadian government created a Department of Public Safety and Emergency Preparedness, a counterpart to the U.S. Department of Security (DHS), and a Border Services Agency. Recent Canadian federal budgets have contained new monies for security-related priorities such as intelligence, maritime and cyber security, threat assessment, and emergency response.

Canada has taken other actions beyond the realm of border security, including freezing terrorists' assets, broadening the scope of terrorist activities punishable by law, extending police investigative powers, introducing legislation that would put restraints on fund-raising activities by extremist organizations, expanding cooperation between the FBI and the Royal Canadian Mounted Police, and increasing outlays for countering nuclear, biological, and chemical weapons attacks.³⁵

In early June 2006, Canadian police conducted a series of raids in the Toronto area, arresting 17 individuals. The arrests were made in accordance with the Anti-Terrorism Act passed late in 2001. The group reportedly had discussed attacking several possible targets, including power plants, a Canadian military base, the Toronto Stock Exchange, and other prominent sites. The plan involved having some members of the group detonate truck bombs while another group reportedly would storm the parliament and capture hostages. Prime Minister Harper was said to have been a key target. Most of the 17 were in their teens or early 20s. All were either Canadian-born or had immigrated to the country at an early age. The suspects had a variety of backgrounds; some were students, some held jobs, and some were unemployed. Many were from middle class backgrounds, and few of them had criminal records.

U.S. officials claimed that the arrests proved that Canada's law enforcement and intelligence services were doing an excellent job of ensuring security. An FBI spokesperson said there was "no imminent threat" to the United States stemming from the Toronto operation. However, some U.S. Members of Congress claimed that Canada maintains lax immigration and asylum policies, and that the arrests demonstrated that stricter controls over the U.S.-Canada border are in order. The incident prompted close consultations between U.S. and Canadian policymakers and law enforcement officials. The operation has not arisen as a domestic political issue in Canada, but it

³⁴ "U.S. Tourists Staying Away from Canada," *Bangor Daily News*, April 6, 2010; International Association of Amusement Parks and Attractions, "Rules of the Road," April 2010, <http://www.iaapa.org/industry/funworld/2010/apr/features/RuleRoad/index.asp>

³⁵ For another brief overview of efforts to secure the U.S.-Canada border, see Joint Counter-Terrorism Initiatives. By Melissa Radford. Border Facilitation: Products and People. By June Dewetering. Both in *Canada and the United States: Shared Interests and Concerns*. Canadian Library of Parliament. January, 2009. http://www.parl.gc.ca/information/library/PRBpubs/prb0834_00-e.htm

has renewed debate about Canada's immigration practices, its commitment to a multicultural environment, its security measures, and the presence of its troops in Afghanistan.³⁶

Economic and Trade Issues

After several years of steady growth, Canada fell into recession in the fall of 2008. Canada's GDP dropped 2.6% in 2009, however, the *Economist Intelligence Unit* and *IHS Global Insight* expect the economy to expand by 3.0% and 3.4%, respectively in 2010. Canada was hard-hit by the weakening of the U.S. economy as the United States is by far the chief customer for export-dependent Canada. Annual consumer price inflation barely registered at 0.3% in recessionary 2009. The unemployment rate, which hit a generational low of 5.8% in January 2008, peaked at 8.7% in August 2009, before gradually falling back to 8.2% by March 2010.³⁷ In 2009, Canada recorded its first current account deficit in nine years in the 4th quarter of 2008, and the collapse in trade led to a CA deficit of \$36 billion for 2009 as a whole.

Budget Policy

Canada entered into recession in the 4th quarter of 2008. While Canada is heavily dependent on the world economy, and thus easily affected by it, some Canadian policymakers believed that the country was in a relatively better position to ride out the economic downturn. After all, Canada had profited handsomely from the resources boom that only began to wind down the summer of 2008. Also, Canadians were reassured by its comparatively more regulated banking system, which was able to avoid the worst excesses of the U.S. financial meltdown. However, Canada could not long avoid the effects of the collapse of the U.S. housing market, the woes of the U.S. automotive sector, and the seizing up of credit markets worldwide.

Canada's Economic Action Plan

Following the reconvening of parliament in January 2009, the government introduced a C\$258.6 billion budget, which called for C\$40 billion in stimulus spending and tax cuts for FY2009-2011. The stimulus consists of a package of income tax cuts, employment insurance (EI) benefit extensions, job retraining, 'hard' infrastructure spending, tax credits for home renovation, retrofits for social housing, and investments in First Nation's health programs.³⁸ In all, the C\$40 billion represents a stimulus of about 1.5% of GDP in the first year and 1.1% in the second year. Increased spending represents approximately 72% of this package and tax cuts contribute the remaining 28%. The March 2010 budget allocated the remaining C\$19 billion in stimulus.

The 2009 budget also marked a return to deficit spending for Canada after 12 successive budgets in balance or surplus. The 2009 budget contemplated a deficit of C\$34 billion the first year, and predicted a total of C\$81 billion in borrowing over five years before the budget is expected to

³⁶ "Canada's Terror Sweep Grabs Spotlight in U.S." *Canadian Press*. June 3, 2006. "U.S. Praises Canada On Terror Arrests But Critics Blast Immigration Laws." *Canadian Press*. June 4, 2006. "Terrorists In Toronto: Is Canada Safe? Are We?" By Tanya Primiani and Christopher Sands. *CSIS Commentary*. Center for Strategic and International Studies. June 20, 2006. "The Toronto Terror Plot." *Economist*. June 10, 2006.

³⁷ Economic data are from Economist Intelligence Unit, wire service reports, and "The Economy In Brief, April 2007." Website of Department of Finance Canada. Updated April 2008. <http://www.fin.gc.ca/ECONBR/ecbr07-04e.html>

³⁸ "Tories to Aggressively Implement Budget Spending Measures," *The Hill Times*, February 2, 2009.

return to surplus in 2013. The March 2010 Budget revised upward the 2009 deficit to C\$53.8 billion, proposed a C\$49.2 billion deficit in 2010, and envisaged the budget returning to balance in 2015 with a total C\$158.4 billion increase in the national debt. The Harper Government plans to return to budget balance by winding down the stimulus measures, targeted spending reductions, and identification of additional opportunities for administrative savings. The Government has pledged not to raise taxes and not cut transfer payments to individuals or equalization payments to the provinces.³⁹ Opposition leaders have expressed skepticism that the budget could return to balance through economic growth and with the scope of spending cuts envisioned in the budget.

The return to deficit spending, while acknowledged as necessary by most of the political spectrum to combat the severe economic recession, was not undertaken lightly. Prior to the 'austerity' budget of 1995, Canada had racked up 27 straight years of deficit spending. At its peak in 1996, Canada's public debt represented 101.6% of GDP, and government sector spending reached 53.6% of GDP in 1993. Realizing this course was unsustainable, the Liberal government of then Prime Minister Jean Chrétien and his Finance Minister Paul Martin embarked on a financial austerity plan using such politically risky measures as cutting federal funding for health and education transfers, applying a means test to those eligible for Seniors Benefits, and cuts in defense. A nationwide goods and services tax was introduced to help close the gap. Under this budget discipline, the government submitted a balanced budget in 1998 and a political consensus emerged not to resort to deficit spending, at least until 2009.

Energy

Canada is the United States' largest supplier of energy—including oil, uranium, natural gas, and electricity—and the energy relationship has been growing. Canada is the world's seventh largest petroleum producer, and its reserves are believed by some to be second only to those of Saudi Arabia; Canada's sources of oil include traditional and offshore wells and, increasingly, Alberta's oil sands. In 2009, the value of U.S. energy imports from Canada dropped precipitously from \$111.3 billion to \$63.7 billion. While some of this drop reflected a recessionary decline in demand, it can also be attributed to the marked drop in energy prices during the year. Canada provides 24.5% of U.S. crude oil imports and supplies 31% of U.S. natural gas imports.⁴⁰ Canada is particularly valued because it is considered a reliable source of energy, as it is not a member of OPEC. The two countries are also cooperating on the development of pipeline construction projects. China has shown interest in Canada's oil sector, and has recently bought stakes in the Alberta's oil sands projects. Canada also a net exporter of electricity to the United States, and the North American electricity grid is closely interconnected. Following the August 2003 blackout, the two sides have worked to develop improved standards for electricity transmission reliability.⁴¹

³⁹ "Budget 2010 in Brief" <http://www.budget.gc.ca/2010/glance-aperçu/brief-bref-eng.html>

⁴⁰ 2009 statistics from U.S. International Trade Commission <http://dataweb.usitc.gov>

⁴¹ Canada-U.S. Energy Relations. Updated April 14, 2009. Canadian Embassy website: http://www.canadainternational.gc.ca/washington/bilat_can/energy-energie.aspx?lang=eng&menu_id=341&menu=L. Country Analysis Briefs: Canada. U.S. Energy Information Administration website. Updated May 2009. <http://www.eia.doe.gov/emeu/cabs/Canada/Background.html>.

Bilateral Trade Issues

The United States and Canada enjoy the largest bilateral commercial relationship in the world; total two-way cross-border trade amounted to over \$1.2 billion per day in 2009. Over the past twenty years, U.S.-Canada trade relations have been governed first by the 1989 U.S.-Canada Free Trade Agreement and, subsequently, by the 1994 North American Free Trade Agreement. These agreements, along with the conclusion of the Uruguay Round of multilateral trade negotiations and the creation of the World Trade Organization, contained mutual concessions on commercial trade barriers, and, more importantly perhaps, established binding dispute settlement mechanisms. While these agreements have resolved some of the sharp differences from the past, questions regarding the effectiveness of dispute resolution mechanism remain.

Meanwhile, several trade issues—some old, some new—have yet to be completely resolved. Many of these disputes involve long-running battles over agricultural commodities or natural resources, including softwood lumber and farm goods. Some analysts attribute the longevity of these conflicts to the inherent incompatibility of the two countries' different natural resource and agricultural programs, others to the political sensitivity of the commodities under negotiation.

Softwood Lumber

A 1996 agreement restricting Canadian lumber exports to the United States expired in March 2001. Shortly thereafter, the U.S. Commerce Department launched countervailing duty and anti-dumping investigations; in May 2002, the International Trade Commission (ITC) found that Canadian imports threatened to injure U.S. industry, and Commerce applied 27% (later reduced) duties on Canadian softwood. Canada challenged the agency decisions under NAFTA and in the WTO.

After several years of inconclusive and sometimes conflicting litigation, the two sides announced that they had struck a seven-year agreement on softwood on April 26, 2006. As part of a complicated formula, the United States will allow unlimited imports of Canadian timber when market prices remain above a specified level; when prices fall below that level, Canada will impose export taxes and/or quotas. In addition, the United States will return to Canada a large majority of the duties it had collected.⁴²

The implementation of the softwood lumber agreement has not been without controversy. As the depressed housing market has reduced demand for softwood lumber, the market price has been under the level (\$355 thousand board feet) in which export taxes must be charged. The United States and Canada resorted to arbitration over the use of adjustment mechanisms to calculate the quotas used for eastern Canadian lumber. The arbitral panel sided with the United States, and after Canada did not implement the panel's recommendation, the United States levied a 10% tariff on the affected lumber to recoup the compensation awarded by the arbitral panel in April 2009. In January 2008, the United States also requested arbitration over six provincial forest sector assistance programs in Québec and Ontario, programs that the United States believes contravene the anti-circumvention provision of the SLA. The results of this arbitration have yet to be announced.

⁴² "U.S. Gets a Lift In Lumber Fight With Canada." By Ian Austen and Clifford Krauss. *New York Times*. August 31, 2005. "Conservative Government Wins Softwood Truce." *Globe and Mail*. April 28, 2006.

Black Liquor

The U.S. pulp and paper industry had been utilizing a tax expenditure intended to increase the use of renewable energy to supplement fossil fuel use. The industry has long produced energy (for internal consumption) from “black liquor”—the liquid waste from pulping liquors used to dissolve the lignin in wood and release the fibers needed to produce paper. The tax program provided a renewable energy tax credit for energy production where renewable sources are added to fossil fuels to reduce the use of fossil fuels in energy production. The pulp and paper industry had found that firms can qualify for the tax credit by adding diesel to their black liquors in producing energy. It had been estimated that the industry could benefit by as much as \$6 billion from this tax program.⁴³ Thus, Canadian firms saw this as an unfair subsidy to the U.S. pulp and paper industry, although the program was not created or intended as an industry-specific subsidy. Legislation to remove this subsidy was enacted as part of the Patient Protection and Affordable Care Act (P.L. 111-148), which became law on March 23, 2010.

Country of Origin Labeling

The 2002 Farm Bill required retailers to provide country-of-origin labeling (COOL) for fresh produce, red meats, seafood, and peanuts. The requirements for seafood were implemented on September 30, 2004, but COOL requirements for other products were delayed until September 30, 2008. The 2008 Farm Bill, The Food, Conservation, and Energy Act of 2008 (P.L. 110-246), reaffirmed this timetable and added goat meat, chicken, ginseng, pecans, and macadamia nuts as covered commodities. A final rule was issued on January 15, 2009, effective March 16, 2009. In November 2009, the WTO established a dispute settlement panel to hear challenges to COOL from Canada and Mexico. Canada claims the rule is a non-tariff barrier that has led to a steep drop in beef and hog shipments to U.S. processors.

Buy American Stimulus Provisions

The Buy American provision of the American Recovery and Reinvestment Act of 2009 (ARRA, Sec. 1605, P.L. 111-5) states that no funds shall be appropriated for building projects or public works projects unless all the iron, steel, and manufactured goods are made in the United States. This provision was subject to three discrete waivers: (a) applying this policy would not be in the public interest, (b) the iron, steel or manufactured products are not produced in sufficient quantities or of a satisfactory quantity in the United States, or (C) the inclusion of the applicable U.S. products would increase the cost of the overall project by more than 25%. The Senate added language to ensure that the provisions are applied in a manner consistent with U.S. trade obligations.

With regard to Canada, the United States has undertaken government procurement obligations under the World Trade Organization’s (WTO) Agreement on Government Procurement (AGP) and under the North American Free Trade Agreement (NAFTA). The AGP is a plurilateral agreement that only binds those WTO members that agreed to undertake obligations under it. Furthermore, the AGP only applies to the sectors and the procurement agencies that the national government (and sub-national government agencies) includes in its schedule of national

⁴³ Lawmakers May Limit Paper Mills’ Windfall. *New York Times*. April 18, 2009.

commitments. NAFTA contains similar commitments on the national level, but excluded sub-national entities.

Both the United States and Canada have undertaken extensive obligations to open their government procurements at the national level under both agreements. However, because Canadian provinces never signed up to the AGP, as had 37 U.S. states, regulations implementing the ARRA excluded Canadian firms from bidding on ARRA-financed contracts that are tendered by the U.S. states.⁴⁴ In February 2010, the United States agreed to permit Canadian firms to bid on sub-federal ARRA contracts in return for a Canadian commitment to sign its provinces up to the AGP. In addition, both parties committed themselves to begin negotiations reciprocally to expand commitments for market access in procurement between the two countries.⁴⁵

Intellectual Property Rights

In 2010, the U.S. Trade Representative again listed Canada on its Special 301 report on intellectual property rights protections to the priority watch list for intellectual property rights protections.⁴⁶ The priority watch list indicates that the listed trading partner has problems with respect to IPR protection, enforcement, or market access for persons relying on intellectual property and that these problems merit “increased bilateral attention.” In this designation, Canada joins such notorious IPR violators as China and Russia. The United States again urged Canada to implement the World Intellectual Property Organization’s Copyright treaty, which has been signed but not ratified by Canada.⁴⁷ The United States also expressed concern about trade in pirated and counterfeit goods in Canada, as well as weak enforcement and relatively lax penalties for IPR infringement. The United States urged Canada to adopt tougher border security measures to crack down on this trade, including allowing for the seizure of pirated and counterfeit goods by customs agents without a court order.

Steel

The global economic crisis caused steel production and prices to fall precipitously in both the United States and Canada. In response to low capacity utilization and low demand for steel, Pittsburgh-based U.S. Steel moved to idle much of its Canadian operations including works in Hamilton and Nanticoke, Ontario in March 2009. U.S. Steel had purchased these works from bankrupt Canadian-based Stelco in 2007 and made certain production commitments during the foreign investment review of its acquisition under the Investment Canada Act (ICA). In May 2009, the Canadian government challenged the closure of the plants as a breach of the commitments it made in its ICA review. In July 2009, after reviewing U.S. Steel’s response, the Canadian government took U.S. Steel Corp. to federal Court, asking the Court to order appropriate measures to remedy the situation. In November 2009, U.S. Steel challenged provisions of the ICA as violative of its procedural rights. Meanwhile, the Hamilton and Lake

⁴⁴ Office of Management and Budget, “Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009, April 3, 2009. pp. 160-166.

⁴⁵ “U.S.-Canada Announce Buy American Deal, Provinces to Sign GPA,” *Inside U.S. Trade*, February 12, 2010.

⁴⁶ United States Trade Representative, 2010 Special 301 Report, p. 25. Available at http://www.ustr.gov/webfm_send/1906.

⁴⁷ The WIPO Copyright treaty updates existing copyright protections for Internet and other electronic media.

Erie works have reopened based on improved demand and U.S. Steel had agreed to sell its Hamilton bar and bloom mills to a German group.

Environmental Issues

The United States and Canada, which share a common border that stretches 5,500 miles, cooperate extensively on environmental matters. Since they signed the Boundary Waters Treaty in 1909, the two countries have, through the International Joint Commission, worked together on protecting and maintaining border waterways, especially the Great Lakes. In 1978, the two signed the Great Lakes Water Quality Agreement.

In 2002, Canada ratified the Kyoto Agreement; in 2006, however, the government announced that emission targets had been exceeded. The Harper government has established a goal of cutting greenhouse gas emissions 20% by 2020. To do so, the government proposes numerous measures, including increased reliance on hydro- and nuclear power, and revised regulations for the oil sands industry.

The long feud over Pacific salmon—one of the more prominent bilateral disputes in recent years—had both environmental and commercial aspects. Canada contended that American fishermen were taking more than their equitable share of the migratory fish; the United States, on the other hand, maintained that its fishing was in accordance with the 1985 Pacific Salmon Treaty (PST) and with sound conservation practices. After a pause, talks resumed in 1997, and the two sides finally reached an accord in 1999; both countries are monitoring implementation of the agreement.⁴⁸ The so-called Annex IV fisheries regimes of the PST were renegotiated in 2008.

One area of contention concerns the diversion of the naturally overflowing waters of Devils Lake, in North Dakota. For flood-control purposes, the state has constructed a channel that diverts excess water ultimately to the Red River, which flows northward. Manitobans have objected to this solution, arguing that the lake water contains toxic chemicals from agricultural runoff; they are also concerned that the introduction of alien species of aquatic life may disturb the ecological balance and endanger recreational fishing in Lake Winnipeg, into which the Red River empties. The Canadian government has requested that the case be referred to the International Joint Commission. In April 2006, after meetings between senior environmental officials of the two governments, the United States agreed to install a permanent filtration system at the Devils Lake outlet. However, this filtration system, estimated to cost \$15 million, has not been installed. In February 2008, the North Dakota Supreme Court found that the state had acted improperly in changing certain environmental standards for the water released from the lake's outlet. At this time, the channel operates intermittently, subject to North Dakota health regulations. Meanwhile, Manitoba has offered to address the issue of a 30 mile border road that acts as a dike, trapping water in northeastern North Dakota, if North Dakota installs the filtration system at the Devils Lake Channel. North Dakota's governor demurred, maintaining that the two issues are unrelated.⁴⁹

⁴⁸ CRS Report RL30234, *The Pacific Salmon Treaty: The 1999 Agreement and Renegotiated Annex IV*, by Eugene H. Buck.

⁴⁹ "Devil Down South." *The Economist*. July 16, 2005. "Little-Known White House Office Negotiates Devils Lake Dispute." *AP*. September 5, 2005. "U.S. Promises Devils Lake Filter, But Water May Flow Before Installation." *Canadian Press*. April 25, 2006. Manitoba Scores Partial victory In Water Dispute With North Dakota. *The Canadian Press*. February 22, 2008; "ND governor to Manitoba: No deal on water dispute," *Fargo Forum*, May 8, 2009.

Other environmental problems the two countries have dealt with in recent years include secondary wastewater treatment, control of predator fish and other invasive species introduced into the Great Lakes by ocean-going vessels, and sustainability of the St. Lawrence Seaway. In addition, the United States and Canada concluded a hazardous waste trade agreement in 1986; more recently, transboundary shipments of solid waste, particularly from Ontario to Ohio, Michigan, and other U.S. states, have been under review, and have been the subject of legislation in the U.S. Congress. The two countries have continued the long-standing debate over the ecological impact of possible development in Alaska's Arctic National Wildlife Refuge. Finally, the two sides continue to monitor the progress of the 1991 Canada-United States Air Quality Agreement. On January 7, 2003, Canadian and U.S. officials announced a new Joint Border Air Quality Strategy; under the initiative, pilot programs to reduce air pollution will be developed involving stakeholders at the state, provincial and local levels.

Canada and Afghanistan⁵⁰

Issue Definition

Canada has participated in military operations in Afghanistan from the outset of the conflict in the fall of 2001. In early 2002, Ottawa deployed troops to Kandahar. However, as the mission changed focus from peacekeeping to counter-insurgency operations involving combat and casualties, Canadian public support declined. Parliament approved legislation requiring Canada to end its combat role by July 2011, and for all troops to be withdrawn by the end of that year. In the fall of 2009, a long-running scandal erupted when it was alleged that Canadian troops had turned over insurgent prisoners to Afghan officials, who subsequently tortured the detainees. The Obama Administration has expressed support for a continued role in Afghanistan by Canada.

Background and Analysis

Canada was one of the first countries to join the U.S.-led military operation in Afghanistan. In October, 2001 the Canadian government launched Operation Apollo, in support of Operation Enduring Freedom. Nearly 900 infantry troops and approximately 40 members of Canada's Special Forces unit, Joint Task Force 2, served in the initial combat in Afghanistan. Canadian forces – about 2,830 currently – have long been serving on the front line in combat operations in southern Afghanistan to counter attacks by al Qaeda and Taliban fighters. Canadian troops operate without national combat caveats. Canada has suffered among the heaviest casualties proportionally of the NATO coalition member states; a total of 142 Canadians, including one diplomat, have been killed in Afghanistan.

In addition to infantry troops, Canada has contributed a helicopter squadron and Operational Mentor and Liaison Team (OMLT) trainers; in addition, Royal Canadian Mounted Police are assisting the Afghan National Police. In August 2005, Canada established a Provincial Reconstruction Team in Kandahar in the volatile southern part of the country. Ottawa also has provided humanitarian and reconstruction assistance to Afghanistan, which is the number one recipient of Canadian foreign aid. Canada is among the top five donors to the country, and has

⁵⁰ Prepared by Carl Ek, Specialist in International Relations; Foreign Affairs, Defense, and Trade Division.

pledged C\$1.9 billion (about \$1.9 billion) through 2011 in reconstruction and development assistance. Canada also currently shares the leadership of Regional Command-South with the Netherlands and the UK.

As Canadian military operations in Afghanistan shifted from peacekeeping to counter-insurgency, public support for Canada's presence diminished. However, Prime Minister Harper has been willing to challenge public opinion over Canada's participation in Afghanistan; he has been banking on an approach that emphasizes training Afghan troops to replace departing Canadians. In 2006, he won a narrow vote in parliament to keep Canadian troops in Afghanistan for two additional years. Harper initially characterized the mission as humanitarian in nature and also asserted that it was in Canada's national interest to demonstrate its ability to play a leadership role internationally.

In the fall of 2007, Harper appointed an advisory panel to review options on the mission. The commission found that the troop presence was justifiable and that the mission should be maintained until 2011, but recommended that Canadian forces be withdrawn unless NATO allies stepped up their contributions. This became the basis of a compromise between the Liberals and Conservatives. Harper declared that Canadian troops would be withdrawn unless other NATO countries provided an additional 1,000 troops. At the April 2008 NATO summit in Bucharest, France and the United States announced that they would commit 800 additional troops. Canadian troops are now scheduled to end combat activities by July 2011, and withdraw completely by December 2011. At the April 2009 NATO summit, Canada reportedly pledged to send an additional 100 civilian specialists to Afghanistan.

Canada has established six priorities for its activities in Afghanistan: 1) training and mentoring, 2) provision of basic services, 3) humanitarian assistance, 4) cooperation between Afghanistan and Pakistan to control the border and stem the drug trade, 5) supporting democracy and the development of governmental institutions, and 6) political reconciliation.

Canada's Afghanistan mission was thrown into the national spotlight in November 2009, when a Foreign Ministry whistleblower publicly alleged that, in 2006 and 2007, Canadian forces had turned combatant prisoners over to local Afghan authorities, who subsequently tortured the detainees; Foreign Affairs Minister Peter MacKay and other officials denied the charges, but later backtracked somewhat. The controversy, which has generated considerable public interest, has continued into mid-2010. An April 2010 public opinion survey indicated that 39% of Canadians polled supported the Afghanistan mission, down from 59% in mid-2006.

Status of the Issue

In March 2010, U.S. Secretary of State Hillary Clinton said during a visit to Ottawa that she hoped Canada would continue its presence in Afghanistan after 2011, suggesting "a training role instead of a combat role, a logistics-support role instead of front-line combat." Some observers have noted that the Obama Administration and NATO officials have privately expressed concerns that the withdrawal of Canadian troops might prompt other allies to bring their troops home. During a visit to Kandahar the following month, Defense Minister MacKay reiterated the government's intention to end the military mission in 2011. The Harper government has indicated that it might maintain a presence in Afghanistan in a diplomatic capacity, and to assist in developmental tasks.

Questions

1. Canada is set to exit Afghanistan in 2011. Does that mean that all personnel – civilian and military – will be leaving the country entirely, or will some remain to assist in development efforts?
2. What role does the U.S. government hope Canada will play in Afghanistan after the scheduled troop withdrawal? Has Washington made specific requests of Ottawa?
3. In what ways, if any, might the Afghanistan policies of a Liberal government differ from those of the Conservatives?

Canada's Arctic Sovereignty Claim⁵¹

Issue Definition

Scientists have forecast that, by 2030 or earlier, global warming will reduce the Arctic ice pack in Canada's northern archipelago sufficiently to create a "northwest passage" that will permit commercial ship traffic through the summer months. If created, a northwest passage would significantly reduce transit distances for commercial ships operating between certain ports. It could also be used by commercial fishing or cruise ships, ships supporting Arctic scientific research or resource exploration, or military vessels. The presence of ships in the passage could require the establishment and enforcement of shipping lanes and other rules for ensuring safe ship operations, add to existing demands for maritime search and rescue capabilities, and create a risk of environmental damage to the Arctic. The use of the passage by foreign military ships might be viewed as creating potential security risks to Canada (and the United States). Successive Canadian governments have maintained that such a passage would be an inland waterway, and would therefore be sovereign Canadian territory, subject to Ottawa's surveillance and regulation. The United States, the European Union, Japan, and others assert that the passage would constitute an international strait between two high seas.

Background and Analysis

Arctic sovereignty has been an issue for Canada for decades. In 1985, a U.S. icebreaker, the *Polar Sea*, caused an uproar in Canada when it traversed the waters of the northern archipelago without first seeking permission. Afterward, Washington and Ottawa came to an agreement in 1988 under which the United States pledged to notify Canada when its ships would transit the region, and Canada agreed to grant its consent. In recent years, however, the question over who, if anyone, would have control over the regional waters has intensified as scientific consensus has grown that the melting of the polar icecap will open up a Northwest Passage during the summer months.

The debate over the Northwest Passage has commercial, environmental, and security considerations. The opening of a channel of water during the summer months through Canada's 36,000-island arctic archipelago would cut shipping routes between Europe and Asia by 3,000-

⁵¹ Prepared by Carl Ek, Specialist in International Relations; Foreign Affairs, Defense, and Trade Division.

4,000 miles, saving time and fuel costs. However, many Canadians are concerned that unfettered maritime traffic through the region could result in serious environmental hazards ranging from the catastrophe of an oil spill, to more cumulative pollution caused by ocean dumping of ballast and garbage by transiting vessels. In terms of security, the Canadians are concerned that recognition of the passage as international waters would result in free access to naval warships and submarines, including, for example, those of Russia and China.

Canada seeks recognition of its sovereignty over the entire area, among other reasons, because of a strong national identification with its northern regions. Ottawa argues that it has a historical claim based on centuries of Inuit inhabitation—of the islands and of the ice extending from them. From a practical standpoint, Canada wishes to have the ability to enforce protection of the fragile arctic ecosystem and to ensure sustainable commercial fishing practices. In addition, the Canadians want there to be no doubt that they have rights to the region's abundant natural resources, including oil, natural gas, minerals, and precious metals.

The Harper government has been seeking to bolster Canada's sovereignty claim by maintaining and expanding the "Northern Strategy" launched by his Liberal predecessors. The most visible part of Conservatives' plan has been the establishment of a stronger military presence. In July 2007, Harper announced plans for the construction of 6-8 armed, medium-sized icebreakers to patrol the north. The following month, he traveled to Resolute Bay, Nunavut and announced plans to construct a winter warfare training center and deep-water port in the region. He declared that "Canada's new government understands that the first principle of Arctic sovereignty is: Use it or lose it." Some Canadians, however, have criticized Harper for seeking to militarize the debate.

The prospective passage raises jurisdictional questions. Canadians maintain that it would be an internal waterway and would likely require all vessels to register with their coast guard's vessel traffic reporting system. They contend that this would facilitate possible search-and-rescue missions, and would dissuade ships bearing contraband from sailing through the region. There is general agreement that the natural resources in the region are Canadian; the debate concerns free transit rights. Analysts note that the UN Convention on the Law of the Seas calls for the right of transit passage "between one part of the high seas ... and another part of the high seas" In addition, some analysts believe that the recognition of the Northwest Passage as a Canadian inland waterway would set an international precedent that might be viewed as applicable elsewhere in the world. Other governments could echo Canada's sovereignty claim and prohibit the passage of U.S. naval ships, as well as of oil tankers bound for the United States; the Straits of Malacca and Hormuz have been cited as examples. Others, however, such as former U.S. Ambassador to Canada Paul Cellucci, argue that it would be in the interests of U.S. national security if Canada were to manage and police shipping through the straits.

Several possible solutions have been put forward. Some argue that Canada could achieve its objectives through regulations approved by the UN International Maritime Organization. Also, it has suggested that NORAD and the Arctic Council might be able to coordinate cooperative patrolling of the passage. Others—though not the United States—have proposed that the countries bordering the Arctic adopt an agreement prohibiting military, residential, or commercial use of the region, as was done for Antarctica in 1959. Finally, some believe that a renewed and updated version of the 1988 U.S.-Canada agreement would suffice.

Status of the Issue

The Bush Administration did not make a major issue of a potential future northwest passage. On January 9, 2009, the White House issued National Security Presidential Directive 66, entitled Arctic Region Policy. The document reiterated the Administration's stance regarding Canada's sovereignty claim, stating that "the Northwest Passage is a strait used for international navigation." Some observers believe that it is unlikely that the Obama Administration will reverse this stance, and that, for the time being, Ottawa and Washington will continue to "agree to disagree." However, Canadian analysts have argued that the debate over who should manage the straits will intensify if ships carrying hazardous materials or illegal immigrants are discovered in the region. The Harper government has emphasized its commitment to the Arctic region through frequent visits by government officials, most recently by Foreign Minister Cannon in April 2010. Because it has been highlighted as a priority area for the Harper government, this issue will likely continue to be the subject of bilateral discussions between U.S. and Canadian policymakers.

Questions

1. Several governments have taken issue with Canada's assertion of sovereignty over the Arctic waters. Do any foreign countries support Canada on this question? Has the Canadian government offered a legal precedent for its claim?
2. If Canada were to win recognition of its sovereignty over the passage, how might it regulate shipping traffic through the straits?
3. What might be the security, economic and environmental consequences for the United States if Canada were to win its sovereignty claim? If the passage were to be declared international waters?

Border Security Issues⁵²

Issue Definition

Border security has emerged as an area of public concern, particularly after the September 11, 2001 terrorist attacks. Since the terrorist attacks, the United States and Canada have been striving to balance adequate border security with the facilitation of legitimate cross-border travel and commerce. As Congress passes legislation to enhance border security and the Administration puts into place procedures to tighten border enforcement, concerns persist with respect to the potential for terrorists to exploit the border. Congress previously passed significant border security-related legislation as discussed below, and issues pertaining to the oversight of such legislation and their possible policy implications for U.S.-Canada border relations continue to be of interest to Congress. These issues include (1) the requirement that U.S. Citizens, Canadian nationals, and other foreign nationals from countries in the Western Hemisphere, need a travel document to enter the United States; and (2) improvements to infrastructure at the border and ports of entry.

⁵² Prepared by Chad C. Haddal, Analyst in Immigration Policy, Domestic Social Policy Division.

Background and Analysis

Both the United States and Canada have taken various measures to better secure the shared border while simultaneously preventing disruption to the flow of people and trade. Such efforts date back to 1995 and include a 30-point plan, commonly referred to as the “Smart Border Accord” (signed on December 12, 2001). The declaration includes a 30-point (now 32-point) plan to secure the border and facilitate the flow of low-risk travelers and goods through coordinated law enforcement operations, intelligence sharing, infrastructure improvements, improvement of compatible immigration databases, visa policy coordination, common biometric identifiers in travel documents, prescreening of air passengers, joint passenger analysis units, and improved processing of refugee and asylum claims, among other things. On December 3, 2001 the two countries signed a joint statement of cooperation on border security and migration that focuses on detection and prosecution of security threats, the disruption of illegal migration, and the efficient management of legitimate travel. Other efforts to increase border security between the U.S. and Canadian government include the 1999 *Canada-U.S. Partnership Forum* (CUSP) and the February 24, 1995, joint accord, *Our Shared Border*.

Congress also took action to better secure the border by passing the USA PATRIOT Act (P.L. 107-56). The act authorized the Attorney General to triple the number of border patrol personnel and immigration inspectors along the northern border and authorized \$50 million for the former INS to make technological improvements and to acquire additional equipment for the northern border. The Enhanced Border Security and Visa Reform Act of 2002 (the Border Security Act; P.L. 107-173) similarly authorized additional personnel and technological and infrastructure improvements at the borders. The Border Security Act contained a provision that required the development of technology to track the entry and exit of foreign nationals (referred to as the US-VISIT program). Both the USA PATRIOT Act and the Border Security Act required travel documents to be tamper resistant and contain a biometric identifier that is unique to the card holder.

Western Hemisphere Travel Initiative

Congress passed legislation that requires the Secretary of Homeland Security, in consultation with the Secretary of State, to develop and implement a plan as expeditiously as possible to require a passport or other document, or combination of documents, “deemed by the Secretary of Homeland Security to be sufficient to denote identity and citizenship,” for all travelers entering the United States. Commonly referred to as the Western Hemisphere Travel Initiative (WHTI), this provision in the Intelligence Reform and Terrorism Prevention Act of 2004 (P.L. 108-458) requires American and Canadian nationals (and other foreign nationals) to present some form of approved travel document to enter the United States.

The Department of Homeland Security (DHS) and the Department of State (DOS) final rule for WHTI took effect on June 1, 2009. Subsequently, DHS has ended the practice of accepting oral declarations of citizenship at the land border and is currently requiring U.S. citizens to present a passport, some other accepted biometric document, or the combination of a driver’s license and a birth certificate, in order to reenter the country. Moreover, the WHTI final rule requires that U.S. citizens present an approved secure document that denotes identity *and* citizenship at the land border. This rule ends the previous practice of accepting driver’s licenses and birth certificates as proof of identity and citizenship at the border. Approved documents include passport books, passport cards, and frequent traveler cards (such as SENTRI, NEXUS, and FAST), while

additional provisions are made for military identification, tribal cards, and for certain special groups of travelers.

Additionally, some states have entered into agreements with DHS and have developed (or are developing) enhanced driver's licenses (EDL) that include citizenship information and are valid for WHTI purposes. The states currently issuing EDLs are Michigan, New York, Vermont, and Washington. DHS has also stated that they are working with the Canadian government and several Canadian provinces to develop EDLs or other similar documents for Canadian citizens that would be valid for WHTI purposes. Thus, according to DHS, the provinces of British Columbia, Manitoba, Ontario and Québec either do, or will soon, offer EDLs. Prior to its implementation, WHTI fostered much debate in Canada as well as the United States, as some observers voiced concerns that the increased documentation requirements at the border may suppress travel between the two nations. Yet, since its implementation much of the more vocal criticism has dissipated.

Status of the Issue

The U.S. and Canadian governments continue to implement the provisions in the Smart Border Accord. For example, both countries have expanded the NEXUS program to 16 border crossing locations, 33 marine reporting locations, and 8 Canadian pre-clearance locations with kiosks. Both countries continue to explore the feasibility of creating additional joint facilities at agreed upon ports of entry and sharing of information through interoperable technology. Additionally, both countries have begun to take steps to share passenger information on high-risk travelers en route to either country through a risk-scoring scheme that was jointly developed; and in 2004, an automated process to share "lookout" data between both countries was developed. However, negotiations between the U.S. and Canada over two proposed pre-clearance pilot programs were reportedly abandoned by DHS due to sovereignty issues, the right of individuals to withdraw from inspections, and concerns about Canadian legal restrictions on Customs and Border Protection officers' authorities relating to arrests, fingerprinting, and other activities.

Questions

1. The WHTI has made significant changes to the documentary requirements needed to enter the United States. What steps is the Canadian government taking to ensure that Canadian citizens are aware of these changes? Will the Canadian government consider imposing similar requirements on American citizens entering Canada? Will Canada develop its own version of the passport card for Canadian citizens? Will Canadian provinces develop their own EDLs for WHTI?
2. In recent years, a number of different technologies, including the US-VISIT program, have been implemented at northern ports of entry. With the advent of the WHTI, the demand for improved infrastructure will continue to be critical. What measures have been taken by the Canadian government to mitigate the impact of such a demand at its border crossings? Are there collaborative efforts that could be undertaken to alleviate some of the pressure on busy ports of entry?
3. The Smart Border Accord calls on the two countries to develop approaches to move customs and immigration inspection activities away from the border. While such an approach is already present at Canadian airports, there has been interest in expanding it to areas away from land ports of entry. What is the Canadian government doing to facilitate this objective? What was the reason

that negotiations over the land-border pilot program failed? Are there any potential solutions for the problems that led to the pre-clearance pilots to be scrapped?

Border Security: Trade and Commercial Concerns⁵³

Issue Definition

The aftermath of the terrorist attacks on the United States on September 11, 2001 increased scrutiny of the Canadian border as a possible point of entry for terrorists or for weapons of mass destruction. The potential for economic disruption that closing the border would cause has spurred cooperation between the United States and Canada to improve border security in an atmosphere conducive to continued and expanded commerce. This brief details commercial considerations in U.S.-Canadian border security discussions.

Background and Analysis

The issue of border security is linked to the increased integration of the United States and Canadian economies. This integration has been aided by several trade agreements, culminating in the North American Free Trade Agreement of 1994 (NAFTA). These trade agreements not only eliminated tariff barriers between the two nations, but also reoriented Canada's industrial structure towards the United States. Industries in each country are now able to produce goods for a larger continent-wide market, and productivity has increased through increased economies of scale and specialization. Such specialization led to increased bilateral trade, much of it in intermediate products. This integration has, in turn, led to industrial practices such as "just in time" parts procurement that depend on a relatively open border.

The volume of economic activity across the border underscores the extent of economic integration between the United States and Canada. Despite the global economic downturn, the United States and Canada continue to have the largest trading relationship in the world with over \$1.2 billion per day in goods and services crossing the border in 2009. In that year, Canada purchased 19% of U.S. exports and supplies 14.4% of all U.S. imports. The United States supplied 51% of Canada's imports of goods in 2009 and purchased 75% of Canada's merchandise exports; two-way trade with the United States represents nearly 31% of Canadian GDP. In 2009, the Ambassador Bridge and Detroit-Windsor Tunnel complex that links Detroit, Michigan and Windsor, Ontario was the largest trade link in the world with more than 3,200 daily truck crossings totaling more than \$72.3 billion per year.

Action Programs and Initiatives

Several new initiatives to increase security of the border without impeding the flow of commerce were implemented under the Security and Prosperity Partnership (SPP), which in turn expanded on previous bilateral efforts by the United States and Canada, including the Smart Border Action Plan of December 2001 consisting of 4 pillars: the secure flow of people, the secure flow of

⁵³ Prepared by Ian F. Fergusson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

goods, a secure infrastructure, and coordinated enforcement and information sharing. The pillar concerned with the flow of goods consists of initiatives on harmonized commercial processing, supply chain management, clearance away from the border, joint or shared facilities, enhancement of information sharing, and infrastructure improvements.

The U.S. Bureau of Customs and Border Protection's *Customs-Trade Partnership Against Terrorism (C-TPAT)* and the Canadian Border Security Agency's *Partners in Protection Program* are supply-chain security initiatives in which companies undertake audit-based compliance measures to enhance security along the supply chain. Goods shipped under these programs are eligible for preclearance away from the border.

The *Free and Secure Trade (FAST)* is a joint harmonized commercial processing initiative at 21 border locations, which provides for dedicated inspection lanes to goods carried by approved lower-risk shippers, to goods purchased from pre-authorized importers such as C-TPAT, and to goods transported by pre-authorized drivers and carriers. A complementary program (NEXUS) to expedite the secure movement of people has also been established for frequent travelers who have undergone security clearances on both sides of the border.

Another objective of the border security efforts has been the screening of goods entering North America. The ongoing U.S. *Container Security Initiative (CSI)* is designed to pre-screen high risk containers entering the United States at overseas ports of departure. Under the SPP, the three countries will develop common screening methods and technology, establish criteria to identify high risk cargo, and harmonize cargo information technology. Preclearance and prescreening is a possible first step in the creation of a North American security perimeter, a concept whereby clearance occurs at the first point of entrance rather than at the final border.

Status of the Issue

Land preclearance away from the border by U.S. and Canadian customs agents working in each other's territory is an issue that has proven controversial, primarily due to concerns about sovereignty. Joint U.S.-Canada customs teams already operate in the CSI ports of Halifax, Montreal, and Vancouver, as well as Newark and Seattle-Tacoma, although the visiting agent serves only an advisory role with no enforcement powers. The SPP calls for negotiations on a U.S.-Canada preclearance agreement with implementation of two pilot sites, the Peace Bridge (Buffalo, NY-Fort Erie, ON) and the Thousand Islands Bridge (Alexandria Bay, NY-Landsdowne, ON). However, these negotiations were suspended on April 26, 2007. A 2008 GAO report cited disagreements over arrest authority, fingerprinting practices, and the right of individuals to withdraw an application to enter the United States while at the preclearance station. The Obama Administration reviewed this decision, but in August 2009 Secretary Napolitano announced that negotiations to construct a preclearance site adjacent to the Peace Bridge would not be reopened.

A second issue is the ability of the transportation infrastructure to cope with increased security measures. The aging condition and limited capacity of the land border infrastructure preceded the terrorist attacks. For example, the Ambassador Bridge and the Detroit-Windsor Tunnel, which together carry 25% of total U.S.-Canada cross-border traffic, both opened in 1930. Approaches to the crossings, often city streets, have been criticized as inadequate to the commercial needs of the 21st century. This issue affects the efficient implementation of security measures. The FAST system provides for dedicated lanes at land border ports for expedited preclearance. However, these lanes will not save time if the FAST participant cannot access this lane due to congestion or

delays at the points of access. The SPP completed a pilot program that attained a 25% improvement in border crossing times at the Detroit-Windsor gateway in December 2005, yet the aging and adequacy of the border infrastructure may affect whether such improvements are sustainable.

There are two competing plans to build additional bridge capacity over the Detroit River to ease truck congestion on the Ambassador Bridge. One proposal involves building a new span adjacent to the Ambassador and has been put forward by the private owner of the bridge. A competing proposal, the Detroit River International Crossing (DRIC), would be built approximately 2 miles south of the Ambassador between Zug Island in Detroit and Brighton Beach area of Windsor. The DRIC proposal is supported by the Canadian government, which believes a new span should not be privately held. To this end, Canadian Transport Minister John Baird has offered to loan the State of Michigan \$550 million to fund its share of the new bridge, the total cost of which is expected to be \$5.3 billion. The Michigan legislature is considering the proposal. Meanwhile, the owner of the Ambassador Bridge has brought a North American Free Trade Agreement (NAFTA) investor-state dispute over his contention that the proposed rival bridge would divert traffic (and tolls) from his bridge.

Questions

1. Is Canada doing enough to secure the border against the transit of terrorists or weapons of mass destruction? Do Canadians think that the United States has placed too much emphasis on securing the northern border against terrorists to the detriment of efficient trade relations?
2. Do you believe land preclearance threatens Canadian sovereignty? What do you think of the decision to terminate the land-precleanance pilot projects?
3. Are Canadian business and government officials concerned that another terrorist-related border shutdown could cause the relocation of business to the United States or dampen the attractiveness of Canada as a recipient of foreign investment?
4. How important is building a new Detroit-Windsor bridge to cross-border trade? The owner of the Ambassador Bridge has offered to assume the cost of building a twin span adjacent to the current bridge. Why not let him?

Immigration and Refugee Policies⁵⁴

Issue Definition

Should the United States be concerned that Canada's immigration and refugee laws and policies pose a threat to its national security?

⁵⁴ Prepared by Stephen F. Clarke, Senior Foreign Law Specialist, Western Law Division, Law Library of Congress.

Background and Analysis

Although Canada does not have country or worldwide immigration quotas, the government does establish annual targets. Between 2004 and 2008, Canada accepted between 235,000 and 262,000 new permanent residents annually. In this same period, an average of between 90,000 and 100,000 persons were accepted annually as temporary workers. New arrivals as permanent and temporary residents total more than 1% of the entire Canadian population. Asian countries, such as China, India, Pakistan, and the Philippines, are heavily represented at the top of the list of countries from which Canada's immigrants come, but no one nation dominates. Iran is the only country adjacent to the Middle East that recently has been in the top ten. Security checks are conducted by federal authorities. Because Québec, however, has an agreement with the federal government that allows it to select immigrants intending to settle in that province, Québec's system adds a second screening process for its applicants. Québec also has addressed security concerns by adjusting its programs for recruiting immigrants. The federal government and Québec use point systems for assessing independent applicants that were changed ten years ago to attract more highly skilled and educated immigrants, regardless of whether they had arranged employment or not. Under this system, Canada has long accepted a much higher percentage of independent immigrants and a much lower percentage of family class immigrants than the United States. A decision to give priority to the processing of certain applicants who have arranged employment drove the balance of the skilled worker category even higher relative to family class immigrants, to a ratio of approximately 2.3:1 in 2008.

One notable feature of Canadian immigration is that nearly three-quarters of the persons accepted settle in the three largest cities: Toronto, Montreal, and Vancouver. This tendency, combined with the high rate of immigration, has raised some concerns about destructive "diaspora nationalism" emerging in these concentrated communities. The 2006 arrests of a group of Muslims who had been raised in Canada and had planned attacks in southern Ontario fueled this concern. However, this problem is not unique to Canada and opposition to immigration has not been voiced nearly as loudly or as forcefully in Canada as it recently has been in parts of Western Europe. In fact, immigration is still generally viewed as an opportunity for growth in what would otherwise be a declining population.

The Canadian policy for asylum applicants is a far more contentious issue within the country than immigration, not so much for its negative effects within Canada, but because it generally is believed to invite fraud and abuse. Between 1998 and 2004, refugee claims began at around 25,000, rose to a high of about 45,000, and ended back down at approximately 25,000. In 2007, the number of refugee claims was approximately 29,500, but it rose again to nearly 38,000 in 2008. The acceptance rate has consistently been somewhat higher than in the United States. In 2006, 47% of the refugee applications processed were accepted. In 2008, it reportedly rose to 58%. Of particular concern to Canadian officials prior to 2005 was the fact that approximately 40% of the overall total claimants and some 70% of port-of-entry claimants had entered Canada through the United States. Canada is attractive to asylum applicants because it detains few undocumented refugee claimants pending independent identification and because the federal and provincial governments grant immediate assistance to applicants who have yet to substantiate their claims. The result has been that the majority of Canada's refugee claimants arrive in Canada without any documents and are allowed free entry into the country, even though it is clear that many disposed of the documents they had before coming to Canada. Canada is also attractive to refugee claimants because it does not often detain undocumented arrivals.

Several U.S. television programs that have portrayed the Canadian refugee system as extremely liberal have received considerable attention in Canada. Most of these segments have mentioned cases of terrorists from the Middle East who did or may have entered Canada as refugees with the intention of launching attacks against U.S. targets. The most prominent of these cases is that of the “millennium bomber.” Ahmed Ressaam was captured in 1999 while crossing the border with explosives that he planned to set off at Los Angeles International Airport on January 1, 2000. Also highlighted have been the cases of suspected terrorists who have remained in the country for many years while fighting their way through a very lengthy appeal process. In 2002, the Supreme Court of Canada ruled that two persons linked to terrorist organizations could be deported to countries where they might face torture, when security concerns so require. One of these individuals was returned to Iran fairly quickly, but the other continued fighting his extradition to Sri Lanka.

Media coverage of the Canadian refugee system has elicited a wide range of responses. While a number of Canadian commentators agree that the United States has good reason to fear that Canada’s refugee policies can be easily employed by terrorists to enter North America, others contend that terrorists are more likely to use other means to enter both Canada and the United States. Many analysts point out that the refugee system essentially has been used for “queue jumping” by enterprising persons who might not qualify under Canada’s immigration laws. Proponents of this view are exasperated by repetitions of the well-refuted myth that the September 11 hijackers came from Canada and question how great the security risk to the United States can be if a significant number of claimants are coming to Canada from this country.

In December 2002, the United States and Canada signed a Safe Third Country Agreement to allow immigration officials in both countries to require most persons seeking asylum at a border crossing to go back and present the claims in their respective countries. This type of agreement had been called for in the Action Plan to the Smart Border Declaration signed in the aftermath of the September 11 attacks in the United States. Implementation of the Agreement was delayed by the lengthy and complicated process for drafting and approving appropriate regulations in the United States, but it finally went into force at the beginning of 2005. In 2007, a judge of the Federal Court of Canada held that the law implementing the Agreement was unconstitutional, based on his finding that the United States does not fully comply with international conventions on refugees. However, in 2008, the Federal Court of Appeals upheld the Safe Third Country Agreement, in a decision the Supreme Court of Canada decided not to review in February 2009.

Although the Safe Third Country Agreement aims to limit asylum shopping and the filing of multiple claims, it is limited in scope and subject to several major exceptions. One major limitation is that it only covers the presentation of claims at land border crossings. Airport and marine facilities are not covered except in very limited circumstances. The Agreement also contains broad exceptions for relatives, including relatives of other asylum seekers, and it allows the parties to “examine any refugee status claim made to that party where it determines that it is in the public interest to do so.” Statistics show that the number of refugee claims presented at border crossings in Canada declined by approximately 40% in the first half of 2005, and fewer than 20,000 total claims were filed for the entire year. Although the data would suggest that the Safe Third Country Agreement had a dramatic immediate impact, it also has been noted that claims presented at airports, which are not subject to the Agreement, initially were down about 25%. Thus, the Safe Third Country Agreement appears to have gone into effect during a period in which the number of refugee claims already was declining. Since then, refugee claims have increased again.

Status of the Issue

One longstanding problem in Canada is that deportation is a very complicated and lengthy process. The number of persons deported has been growing, but Canada's Auditor-General found in May 2008 that the government did not know the whereabouts of approximately two-thirds of the over 60,000 persons who were subject to deportation or removal orders. Included in this group are persons who were found to be inadmissible on the grounds of criminality. While the Auditor-General was critical of the situation, she did not find that the missing persons constituted a clear national security risk.

At the end of March 2010, the Minister of Citizenship, Immigration, and Multiculturalism declared that "Canada's asylum system is broken" and announced plans to reform it. The Government aims to reduce the 19 months it now takes to process the average refugee claim and the 4.5 years it now takes to remove the average failed refugee claimant. The goals are to have refugee claims heard within 60 days of being presented and removals of persons found not to be entitled to refugee protection to less than one year. This is not the first time such intentions have been announced. Over the past thirty years, every Canadian Government has announced plans to address shortcomings in the country's refugee laws. Some reforms have been enacted, but the problem of abuse has continued to grow.

Questions

1. Could the Safe Third Country Agreement have had a broader application and apply to persons making applications for refugee status within the country?
2. Are the reported cases of terrorists and high-risk persons entering North America through legal means a sign of a potentially much greater threat?
3. Why do Canadian and U.S. officials maintain different detention policies in the case of undocumented refugee claimants?
4. What steps does the Canadian government intend to take to keep track of persons subject to deportation or removal orders?
5. Why does the Government believe its current efforts to "fix" Canada's "broken" asylum system will succeed when so many previous efforts over the past thirty years have failed?

Canada's Free Trade Agreement Agenda⁵⁵

Issue Definition

While the current Doha Round of multilateral World Trade Organization (WTO) negotiations remain stalled, regional and bilateral free trade agreements (FTA) have become a prominent, if

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controversial, feature of the world trading system. In the past, the United States was relatively more aggressive in pursuing FTAs, while Canada emphasized multilateral trade liberalization to supplement liberalization with its predominant partner, the United States, first through the U.S.-Canada FTA and subsequently through the North American Free Trade Agreement (NAFTA). This trend has shifted with Canada negotiating to conclude several FTAs, while in the United States, proposed FTAs with Colombia, Panama, and South Korea await congressional consideration in an uncertain environment.

Background

After concluding the U.S.-Canada FTA in 1988 and expanding it to include Mexico in 1994, both countries made the new WTO the cornerstone of further trade liberalization. While both countries concluded FTAs, political rationales were often paramount. For example, close ties prompted both countries to conclude FTAs with Israel. Canadian attempts to establish a greater role in Latin America were reflected in FTAs with Chile (1997) and Costa Rica (2002). Negotiations were started with the European Free Trade Area nations (Norway, Switzerland, Iceland, and Liechtenstein) in 1998, with Singapore and with the Central American Four (El Salvador, Guatemala, Honduras, Nicaragua) in 2001, and with South Korea in July 2005. However, none of these negotiations yielded an agreement during the Liberal governments of Jean Chrétien and Paul Martin. Moreover, the importance of such agreements was overshadowed by the overwhelming volume of Canadian trade that continued to be conducted under NAFTA, with the United States continuing to account for the bulk of that trade.

In 2001, the George W. Bush Administration embarked on a new trade strategy known as “competitive liberalization.” This policy pushed forward trade liberalization simultaneously on bilateral, regional, and multilateral fronts. It was designed to spur trade negotiations by liberalizing trade with countries willing to join FTAs, and to pressure other countries to negotiate multilaterally. A pending agreement with Jordan, negotiated with the Clinton Administration was passed by Congress in 2001. Under trade promotion authority (TPA) passed by Congress in 2002 and in effect until 2007, FTAs were negotiated and approved by Congress with Chile, Singapore, Australia, Morocco, the countries of the Central American Customs Union and Dominican Republic (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic), Bahrain, Oman, and Peru. In addition, negotiations were conducted with the nations of the South African Customs Union (SACU) (Botswana, Lesotho, Namibia, South Africa, and Swaziland), the United Arab Emirates, Malaysia, and Thailand, but they resulted in no agreement. Negotiations with Colombia, Panama, and South Korea were concluded under TPA, but have yet to receive congressional consideration. Currently, the Obama Administration’s trade policy has stressed enforcement of existing trade agreements rather than negotiating new ones or seeking approval for the three pending agreements. The one exception has been the launch of the Trans-Pacific Partnership (TPP) talks among the United States, Australia, Brunei, Chile, New Zealand, Peru, Singapore, and Vietnam.

The Conservative government of Prime Minister Stephen Harper, first elected in 2006, has placed greater emphasis on negotiating regional and bilateral FTAs. Existing negotiations with EFTA were concluded in January 2008, resulting in an agreement that was approved by Parliament in January 2009 and received Royal Assent in April 2009. Negotiations with Peru and Colombia were initiated in June 2007. An agreement was signed with Peru in May 2008, which was approved by Parliament in June 2009 and received Royal Assent later in the month. Negotiations with Colombia were concluded in November 2008 and the bill received a procedural 2nd reading

approval in Parliament on April 19, 2010. An FTA with Jordan was concluded in August 2008 and was introduced in the current Parliament on March 24, 2010. In general, the Conservative and Liberal parties have voted to approve these agreements, but have been opposed by the labor-influenced New Democratic Party (NDP) and the Québec-separatist Bloc Québécois.

In addition, negotiations have been started with Panama, the Dominican Republic, and the nations of CARICOM, and are continuing with South Korea, Singapore and the Central American Four. With South Korea, issues familiar to U.S. negotiators such as market access for beef and non-tariff barriers in the auto sector are complicating the talks. Canada has also expressed interest in the TPP, but reportedly has encountered resistance from New Zealand and the United States over its dairy supply management policies.

In May 2009, Canada and the European Union (EU) agreed to launch FTA negotiations, and 3 rounds of negotiations have occurred thus far. This negotiation is significant in that it raises issues of concern to countries at a similar level of development and with relatively low tariffs. Issues that have been flagged include the regulation of professional services, temporary entry for business workers, and provincial participation in government procurement agreements. Agreement on this latter point may become easier following the U.S.-Canada agreement on Buy American provisions in the U.S. economic stimulus. (See related section on Buy American Provisions.) Negotiations on agriculture likely will prove challenging as both sides will likely seek to protect sensitive sectors, yet negotiations on traditional sticking points such as the EU's desire to protect geographic indications and Canadian supply-management policies reportedly have not been precluded.

Status of the Issue

The Conservative government's new enthusiasm for negotiating FTAs was recently expressed by International Trade Minister Peter Van Loan on April 23, 2010. Canada is pursuing FTAs "with a vigor right now because we're a trading country, our businesses need it, our workers need it, our prosperity depends on it, so we're going to make it happen for Canada and not simply depend on the WTO." While in some ways this policy resembles the 'competitive liberalization' policy undertaken by the George W. Bush Administration, it remains to be seen whether agreements resulting from such negotiations, will increase trade flows and lessen the dependence of Canada on the U.S. market. It also remains to be seen whether Canada will retain its traditional engagement in the WTO.

Questions

How controversial is the Canadian Government's trade policy? Does the public approve of further trade liberalization? How does the continuing decline of the Canadian manufacturing sector affect public attitudes towards free trade generally?

Do you think the emphasis on negotiating bilateral and regional FTAs complements or weakens the multilateral trading system? Does this policy reflect a lack of confidence in the ability to conclude the WTO Doha Round, or that Canada will not benefit much from a Doha agreement?

In the United States, labor and human rights concerns have delayed the passage of the proposed Colombia FTA. How evident are such concerns in Canada? Do Canadian business view the

prompt passage of the Canada-Colombia FTA as a way to get a “leg up” in competing with U.S. firms for that market?

Should Canada actively try to join the TPP negotiations? Would joining the TPP advance the objective, promoted by successive Canadian governments, of expanding Canada’s role in the Asia-Pacific region? Is Canada prepared to address liberalization of its dairy supply management programs?

G-8 and G-20 Leader Summits, June 2010⁵⁶

Issue Definition

The G-8 and the G-20 are international forums where leaders and ministers of major countries gather to discuss and coordinate international policies. The G-8 is a group of advanced countries (Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States), while the G-20 also includes major emerging-market countries (the G-8 plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, and the European Union (EU)). Canada holds the G-8 rotating presidency in 2010, and as part of these duties, Canada is hosting the annual G-8 leader summit on June 25-26 in the Muskoka region of Ontario. After it was announced by the G-20 leaders in September 2009 that, henceforth, the G-20 would be the premier forum for international economic coordination, it was decided that Canada would also host a G-20 leader summit in Toronto (June 26-27) immediately following the G-8 summit. South Korea is the chair of the G-20 in 2010 and is to hold a G-20 summit in November in Seoul.

As host of the annual G-8 summit and the June G-20 summit, Canada has strong influence on the meetings’ agendas. Canada has announced it will champion a major initiative to improve the health of women and children in the world’s poorest regions during the G-8 summit. The theme of the June G-20 summit is “Recovery and New Beginnings.” The agenda is expected to emphasize financial sector reform, exit strategies for government stimulus packages to address widening government deficits, and ongoing multilateral efforts towards trade liberalization.

Background and Analysis

The G-8, the G-20, and the Financial Crisis

Since the mid-1970s, leaders from the G-7 (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States), a small group of developed countries, have gathered annually to discuss and coordinate financial and economic policies. Over time, the G-7 focus on macroeconomic policy coordination expanded to include a variety of global and transnational issues, such as the environment, crime, drugs, AIDS, and terrorism. In the late 1990s, Russia was included in the G-7 discussions on non-economic issues, creating the G-8.

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The G-20 was formed in the late 1990s, after the Asian financial crisis in 1997-8 illustrated economic interdependence between developed and emerging-market countries, and that emerging markets were too important to exclude from international economic discussions. The G-20 remained a less prominent forum than the G-7 until the onset of the financial crisis in fall 2008, when the G-7 leaders decided to meet as the G-20 leaders to discuss and coordinate policy responses to the crisis. To date, the G-20 leaders have held three summits to coordinate policy responses to the crisis: November 2008 in Washington, DC; April 2009 in London; and September 2009 in Pittsburgh. At the Pittsburgh summit, the G-20 leaders announced that the G-20 would henceforth be the premier forum for international economic coordination, supplanting the G-8's role as such.

Perhaps the most central theme of the three G-20 summits held to date has been financial regulatory reform. The G-20 leaders pledged to expand the transparency of complex financial instruments, strengthen and harmonize capital standards, reassess banker compensation, regulate all systemically important financial institutions, regulate credit rating agencies, and combat illicit financial activities, among other commitments. The G-20 leaders have made commitments on a variety of issue areas, including tripling the resources of the International Monetary Fund (IMF), creating a new framework to monitor and coordinate economic policies, voting reform at international financial institutions, climate change, foreign aid, and trade.

Discussions on June G-20 Summit Agenda

There have been three major discussions in the run up to the June G-20 summit. First is the status of implementation of commitments made in previous G-20 summits. The Financial Stability Board (FSB) has been tasked by the G-20 to keep track of whether and how the G-20 are delivering on their regulatory reform commitments. In March, the FSB released its first report on implementation of banker compensation reform. The FSB reports that some developed countries have issued new regulations on banker pay, while others have delegated the responsibility through bank supervisors. In developing countries, implementation has been much slower and in many countries is still under consideration. Weaker implementation of the G-20 commitments was a concern for some when the G-20 superseded the G-7/G-8 as the premier forum for international economic discussions, due to the diverse group of countries included in the G-20. Others argued that including emerging markets in the discussions was necessary given their increased role in the world economy.

Second, debate is currently underway about whether to add an additional commitment on regulatory reform at the June G-20 summit: a tax (or levy) on banks to help fund the costs of bank bailouts. Currently, several European countries support bank levies, Obama proposed the introduction of a bank levy in January, and the IMF released a report in April supporting the introduction of bank levies. (A bank levy is not included in the House regulatory reform bill (H.R. 4173) or Senator Dodd's regulatory reform bill (S. 3217). As a tax, such a proposal would likely go through the Senate Finance Committee and the House Ways and Means Committee.) Within this broad support for a bank levy among the Europeans, the Obama Administration, and the IMF, there is some disagreement about how it would be implemented, for example, the size and duration of the tax. Canada, by contrast, has expressed strong opposition to a levy, because its banks fared well during the crisis and the Canadian government did not need to bail out its banks. Australia is reported to be reticent on the issue. The Bank of Canada Governor Mark Carney is reported to have said that the bank levy is a "distraction" from other issues, such as capital and liquidity reforms and the world economic recovery. It is reported that some G-20 officials believe

that, as host of the June 2010 summit, Canada's opposition to a bank levy will slow any progress on the bank levy until the November G-20 summit in South Korea.

Third, at the Pittsburgh summit in September 2009, the G-20 leaders announced the creation of a new framework to peer review economic policies and that the results of the first mutual assessment would be reviewed at the next G-20 summit in June 2010. The IMF is playing a central role in the assessment process but it is unclear how the framework will operate in practice and whether it will be effective at correcting and preventing global imbalances. Although in January 2010 the Canadian Finance Minister, Jim Flaherty, reportedly said that he expected global imbalances to be a central focus of the G-8 and G-20 summits, discussion of bank levies has dominated debate over the G-20 agenda in recent weeks. Global imbalances appear to be a priority for Canada, however. It is reported that the Canadian government has expressed concern that an inflexible yuan, which many believe to be a key driver behind global imbalances, pushes the burden of adjustment on Canada's own currency, increasing its volatility.

Status of the Issue

Preparations for the G-8 and the G-20 summits are well underway. As customary for the G-8 president, Canada has hosted a number of meetings among the G-7 and G-8 ministers in preparation for the G-8 summit. These meetings include the G-8 foreign ministers (March 29-30, Québec), the G-8 development ministers (April 26-28, Halifax), and the G-7 finance ministers (February 5-6; Iqaluit). (As a smaller and less developed economy, Russia has historically not been included in the G-7 finance minister meetings.) Similarly, meetings among the G-20 labor ministers, finance ministers, central bank governors, and finance minister deputies to prepare for the 2010 G-20 summits have or will be held in Washington, DC and Seoul.

Questions

1. Does Canada believe that the bank levy should be on the June G-20 summit agenda? How has Canada's views on the bank levy evolved in recent weeks, particularly in light of the IMF report broadly supporting the use of bank levies?
2. Last winter, it was reported that Canadian Finance Minister Jim Flaherty expected global imbalances and fixed exchange rate currencies to be a central focus of the June G-20 summit. Is this still the case? How does Canada hope to use the G-20 forum to effectively address fixed exchange rates and global imbalances?
3. There are only five months between the June G-20 summit in Canada and the November G-20 summit in South Korea. What does Canada hope to accomplish in the June G-20 summit to effectively prepare for the November G-20 summit?

North American Cooperation on Competitiveness and Security⁵⁷

Issue Definition

How can the United States cooperate with its North American neighbors on issues related to trade, transportation, and security? How are the United States, Canada, and Mexico cooperating on improving competitiveness and security in North America?

Background and Analysis

At the 2009 North American Leaders Summit in Guadalajara, Mexico, President Barack Obama met with Canadian Prime Minister Stephen Harper and Mexican President Felipe Calderón to discuss issues of prosperity and security in North America. The three leaders renewed their commitment to regulatory cooperation by instructing ministers in the three countries to build upon previous efforts, develop focused priorities, and form a specific time line. The three countries confirmed their commitment at an October 2009 meeting of the Free Trade Commission (FTC).

The Bush Administration's main efforts to increase North American cooperation were made through the Security and Prosperity Partnership of North America (SPP), a trilateral government initiative launched in March 2005. The main goal was to increase and enhance prosperity in the United States, Canada, and Mexico through regulatory cooperation. Though the SPP forum is no longer active, much of the prior work on the underlying issues is continuing under the Obama Administration. The SPP was endorsed by all three countries, but it was not a signed agreement or treaty and, therefore, contained no legally binding commitments or obligations. It could, at best, be characterized as an endeavor to facilitate communication and cooperation across several key policy areas of mutual interest. Although the SPP built upon the existing trade and economic relationship of the three countries, it was not a trade agreement and distinct from the existing North American Free Trade Agreement (NAFTA). The efforts to increase North American cooperation under the SPP were *not* an effort to create a common market in North America. Such a move would require a government approval process within each of the three countries.

Past efforts to increase North American regulatory cooperation focused on the recommendations of special working groups created under the SPP. The latest recommendations came in 2008 when the groups agreed to continue to identify and focus on a set of high priority initiatives: 1) to increase the competitiveness of North American businesses and economies through more compatible regulations; 2) to make borders smarter and more secure by coordinating long-term infrastructure plans, enhancing services, and reducing bottlenecks and congestion at major border crossings; 3) to strengthen energy security and protect the environment by developing a framework for harmonization of energy efficiency standards and sharing technical information; 4) to improve access to safe food, and health and consumer products by increasing cooperation and information sharing on the safety of food and products; and 5) to improve the North American

⁵⁷ Prepared by Angeles Villarreal, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

response to emergencies by updating bilateral agreements to enable government authorities from the three countries to help each other more quickly and efficiently during times of crisis.

North American efforts regarding the prosperity initiative have consisted of increasing cooperation in areas related to information sharing, productivity improvement, reductions in the costs of trade, and enhancement of the quality of life. The three countries have also addressed the need to enhance North American competitiveness through compatible regulations and standards that would help them protect health, safety and the environment, as well as to facilitate trade in goods and services across borders.

Efforts regarding the security initiative have focused on cooperative activities undertaken by each country on protecting citizens from terrorist threats and transnational crime, while promoting the safe and efficient movement of legitimate people and goods. Working groups have been organized along three broad themes: 1) external threats to North America; 2) streamlined and secured shared borders; and 3) prevention and response within North America. The three countries also have cooperated on how to design policies that facilitate the efficient entry of legitimate cargo while simultaneously ensuring that a sufficient level of security and scrutiny is applied to deny the entry of illegitimate cargo.

Some critics of the SPP believed that it was more than an initiative to increase cooperation and that it could have led to the creation of a common market or economic union in North America. Others contended that it would ultimately lead to a so-called “NAFTA Superhighway” that would link the United States, Canada, and Mexico with a ‘super-corridor’. Others view the initiatives as constructive to addressing issues of mutual interest and benefit in North America. Business groups supported the initiative and believe that North American cooperation is necessary to enhance the competitiveness of U.S. businesses in the global market.

If the United States were to potentially consider the formation of a customs union or common market with its North American neighbors, it would require approval by the U.S. Congress. The U.S. government has made no plans to pursue a “North American Union” with Canada and Mexico. Neither has the federal government made any plans to build a “NAFTA Superhighway,” nor for a super-corridor initiative of any sort. Further, no legal authority exists and no funds have been appropriated to construct such a superhighway.

Status of the Issue

The United States, Canada, and Mexico have made progress in recent years in addressing issues related to North American competitiveness and security. The Obama Administration has affirmed its commitment to continue past efforts on North American cooperation but under a different approach from the SPP framework. The SPP served as a mechanism to increase communications among North American trading partners on issues of mutual interest, but because it was not a binding agreement, its role in improving prosperity and security was limited.

Questions

1. How effective has North American cooperation been in improving competitiveness through its focus on intellectual property rights protection and regulatory harmonization? What other steps can be taken by the three countries to improve competitiveness?

2. How effective has North American cooperation been in improving safety, security, and the flow of goods and services among NAFTA partners? What other steps could be taken in these areas?

Canada's Financial System⁵⁸

Issue Definition

Canadian banks on the whole weathered the recent financial crisis better than banks in the United States and Europe. Canada's financial system was buffeted by the financial crisis as equity and housing prices fell and as economic growth decreased as a result of the downturn in global trade. Are there lessons to be learned from Canada's banking system, which has proven to be somewhat more immune to the financial troubles that have brought down better known banks?

Background and Analysis

Canada's financial system proved to be more resistant to the failures and bailout that marked systems in the United States and Europe. Nevertheless, the financial crisis and global economic recession battered the Canadian economy in ways that are similar to those in the United States and in Europe. The Bank of Canada recently forecast that growth in the Canadian economy would rebound in 2010 by 3.7% due to lingering effects of fiscal and monetary stimulus experience. In January 2009, the Canadian Government announced a US \$33 billion fiscal stimulus package over two years in infrastructure spending, tax decreases, worker retraining, housing, and aid to struggling industries to spur the Canadian economy. The housing sector is experiencing strong growth as a result of low interest rates and consumer spending has responded to the fiscal stimulus. The strong Canadian dollar combined with a relatively lower rate of productivity in Canada and weak demand for Canadian exports from the United States are expected to act as a significant drag on economic growth in the second half of 2010.

During the recent financial crisis, Canadian banks suffered a loss of 50% in the value of their equities and the Canadian Imperial Bank of Commerce lost \$2.1 billion in derivatives. The Bank of Canada, however, was not forced to follow other central banks by injecting capital into any Canadian bank. With ample liquidity and low funding costs, Canadian banks have been in a position to provide additional support to the Canadian economy. Borrowing costs for Canadian households have remain low and mortgage and consumer credit have grown at a faster pace than was expected by the Bank of Canada.

In a recent assessment of Canada's financial system, the IMF concluded that Canada's system is highly mature, sophisticated, and well-managed. In addition, the system is characterized by strong prudential regulation and supervision and a well-designed system of deposit insurance and arrangements for crisis management and resolution of failed banks. Supervisory responsibility for the financial sector in Canada is divided among the federal government, the provincial governments, and among a group of agencies within the federal government. The federal government is responsible for supervising all banks, federally incorporated insurance companies, trust and loan companies, cooperative credit associations and federal pension plans. Provincial

⁵⁸ Prepared by James K. Jackson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

governments are responsible for supervising securities dealers, mutual fund and investment advisors, credit unions, and provincially incorporated trust, loan, and insurance companies. As a result, there are 13 regulatory authorities, each administering a separate set of securities laws and regulations.

Within the federal government, the Financial Institutions Supervisory Committee (FISC) acts as the chief coordinating body that sets regulatory policy and supervises financial institutions. The Committee is comprised of the Department of Finance of the Ministry of Finance and four independent government agencies: the Office of the Superintendent of Financial Institutions (OSFI); the Bank of Canada; the Canada Deposit Insurance Corporation; and the Financial Consumer Agency of Canada (FCAC). All of these agencies report to the Minister of Finance, who is responsible to the Canadian Parliament. The Bank of Canada is responsible primarily for conducting monetary policy by setting interest rate targets and adjusting the supply of credit. The Bank also serves as the key component in the payments system by providing a check clearing function, and it serves as the traditional lender of last resort. The Office of the Superintendent of Financial Institutions plays a key role in Canada's financial supervisory scheme by supervising all domestic banks, branches of foreign banks operating in Canada, trust and loan companies, cooperative credit companies, life insurance companies, and property and casualty insurance companies.

The financial system is dominated by five large banking groups (Royal Bank of Canada, TD Canada Trust, Bank of Nova Scotia, Bank of Montreal, and Canadian Imperial Bank) that account for about 60% of total assets. In comparison, foreign banks account for about 4% of assets. The low representation by foreign banks is attributed to the "widely-held" rule for large banks that limits the concentration of bank share ownership and, therefore, reduces the scope for mergers and for foreign entry through acquisition. Canada's financial legal framework has allowed Canadian banks to concentrate on their low-risk, profitable domestic retail banking activities (services provided to individuals including deposits, savings accounts, mortgages, credit cards, etc.), leaving large domestic borrowers to conduct their wholesale banking activities (services provided to corporations, governments, and other entities) abroad. Canada's insurance sector is dominated by three large domestic groups, which account for over 80% of the assets in this sector. The securities sector is marked by large Canadian, as well as U.S. and U.K. securities firms.

Unlike the United States and some European countries, subprime mortgages account for less than 5% of Canadian mortgages, which sharply limited Canada's direct exposure to the meltdown that occurred in the subprime mortgage market. In addition, Canadian law requires that all bank-held mortgages with a loan-to-value ratio above 80% be insured, which has curtailed the securitization of mortgages by banks in Canada. In addition, prepayment penalties and the lack of interest deductibility reduces the demand for long-term mortgages, so the maturity of most mortgages does not exceed 5 to 10 years.

Canada's financial supervisory system and regulatory structure have proven to be less susceptible to the bank failures that have loomed in the United States and Europe. Nevertheless, Canada's approach has a number of drawbacks. Canada's system of regulating securities markets at the provincial level means that regulations regarding market participants and investor protection differ by province and that the nature, structure, and powers of the provincial regulators also vary. In addition, the conservative, risk-adverse approach employed by Canada's banks shielded the banks from some of the current financial turmoil, the approach also reduces efficiency in the market and reduces competition. Acquisitions of Canadian banks is significantly impeded by the

rule that bank stocks be widely held and mergers are effectively prohibited. With reduced competitiveness pressures, Canadian banks maintain low-risk balance sheets at the expense of greater innovation and more efficient capital allocation. This approach also means that financing for small firms and venture capital for potentially high-growth companies is sharply reduced.

Questions

1. There is much to admire about the Canadian banking system, but do the differences in the size and the scope of the U.S. and Canadian financial markets reduce the importance of the Canadian system as a model for the United States to follow?
2. Are there aspects of Canada's federal supervision of its banking system that could serve as a model for bank supervision by the United States?
3. Canada's approach to financial supervision concentrates the majority of that responsibility in an authority that is separate from the central bank. Although the United States is considering a different approach, are there aspects of Canada's regulatory structure that could be used as a potential model for the United States?

Buy American Provisions⁵⁹

Issue Definition

The Buy American provision of the economic stimulus package, officially known as the American Recovery and Reinvestment Act (P.L. 111-5), requires that iron, steel, and manufactured goods used in the construction of public works projects funded by the act be made in the United States. This provision was widely criticized by U.S. trading partners, including Canada, based on the fear that the act, if not outright inconsistent with U.S. international trade obligations, would set a precedent that could provide the excuse for a cycle of "creeping protectionism" by other nations. However, some analysts note that the relationship between government procurement and the world trading system has always been tenuous, and that disciplines on government procurement have not been as rigorous as those on other trade practices.

Background and Analysis

The Buy American provision of the ARRA states that no funds may appropriated for building projects or public works projects unless all the iron, steel, and manufactured goods are made in the United States. The act provides three discrete exceptions for cases in which a Federal agency administrator finds that (a) applying this policy would not be in the public interest, (b) the iron, steel or manufactured products are not produced in sufficient quantities or of a satisfactory quantity in the United States, or (C) the inclusion of the applicable U.S. products would increase the cost of the overall project by more than 25%. In the case of (a), the public interest waiver has

⁵⁹ This section was written by Ian F. Fergusson, Specialist in International Trade and Finance; Foreign Affairs, Defense, and Trade Division.

been used to invoke the authority granted to the President to waive discriminatory purchasing requirements for signatories of the WTO Agreement on Government Procurement (AGP) contained in the Trade Agreement Act of 1979 (Sec.301, P.L. 96-39). In the case of (c), this cost differential is at variance with the general differential of 6% applicable to most Federal contracts, 12% in cases of small business or minority set-asides, or 50% for most Department of Defense procurements. If any of these provisions are waived, the agency head must publish a justification for the waiver in the *Federal Register*. Finally, the Senate added language to insure that the provisions are applied in a manner consistent with U.S. trade obligations.

The United States and Canada both are signatories to the World Trade Organization's Agreement on Government Procurement (AGP), which came into effect in 1996. Unlike most of the Uruguay Round agreements which make up the WTO system, the AGP is plurilateral in that it only binds those nations that have accepted it. Currently, there are 39 signatories to the agreement, predominantly developed and middle- income countries.

The AGP commits signatories to practice the principles of national treatment and most-favored-nation treatment in the laws, regulations, practices, and procedures concerning government procurement. In this context, national treatment means that a signatory will provide no less favorable treatment to another party's products, goods, and suppliers than its own in its government procurement process, nor will the signatory discriminate between the products, services and suppliers of other parties under most-favored -nation principles. The agreement also provides procedures to insure transparency, including detailed operating rules on the procurement process of the signatory, a challenge procedure by which a rejected bid can be independently and impartially reviewed, and recourse to WTO dispute settlement provisions in cases where the parties cannot resolve their differences.

The AGP only applies to the sectors and the procurement agencies that each government includes in its schedule of national commitments. Each member's schedule lists the national and sub-national agencies as well as other entities that participate, exceptions within those units, and the threshold value for procurement tendered under its obligations. Both the United States and Canada have undertaken extensive obligations to open their government procurements at the national level under both agreements. Thus Canadian firms may bid on ARRA-related federal procurement under the provisions of the AGP. Thirty-seven U.S. states as well as other government entities such as the Tennessee Valley Authority and the Port Authority of New York and New Jersey have made commitments under the AGP. Threshold values do apply for AGP contracts; projects valued under approximately \$7.8 million for construction projects are not covered under the AGP. While Canada has undertaken obligations for several of its crown corporations such as Canada Post and the St. Lawrence Seaway Authority, the ten provincial governments and three territorial governments have not undertaken any obligations under the AGP.

Likely for this reason, the Office of Management and Budget (OMB) excluded Canada from the list of countries to which U.S. states participating in the AGP have international obligations under the AGP. This meant that for state and local projects funded by federal money from the stimulus bill, there was no obligation to treat Canadian firms in a manner consistent with U.S. obligations under the AGP. Thus, Canadian firms would be ineligible to bid on contracts for iron, steel, and manufactured products procured for public works projects undertaken by state and local governments using federal stimulus money.

Each schedule also contains interpretations and exceptions. For example, Federal funds distributed to the states for mass transit and highway projects are excluded. This reflects the Buy American provisions of the Surface Transportation Act of 1982 (P.L. 97-427) and the Urban Mass Transit Act of 1964 (P.L. 88-365). In addition, twelve states exclude the procurement of construction-grade steel, motor vehicles and coal from their obligations under the AGP and states have excluded other products and services as well. Canada has exempted certain of its procurement activities from coverage under the AGP such as shipbuilding and repair, and urban rail and urban transportation equipment, including specifically all project related materials of iron or steel.

Status of the Issue

Some Canadian industries were reportedly hard-hit by the Buy American provisions, especially those firms that comprise part of an integrated supply chain. In addition, there had been several anecdotal reports in the Canadian press that U.S. contractors and suppliers are increasingly choosing to source domestically in order not to be hassled with complying with Buy American provisions even in cases where procuring from Canadian firms would be consistent with ARRA. As a result, the United States and Canada started negotiations to resolve this dispute in August 2009. The resulting agreement, which became effective on February 16, 2010, waives the Buy American provisions for Canadian firms bidding for ARRA contracts tendered from 7 federal programs in the 37 states that participate in the AGP until September 30, 2011. In return, Canada's provinces and territories will become signatories to the AGP, opening procurement opportunities to U.S. firms. This agreement will only affect procurement tenders yet to be awarded; this action will not reopen existing contracts. The agreement also commits the parties to begin negotiations reciprocally to expand commitments for market access in procurement between the two countries. The ability of Canadian firms to benefit from the immediate terms of the agreement may depend on the value of the stimulus projects that have yet to be awarded.

Questions

1. Did the initial exclusion of Canadian firms from bidding on certain state stimulus projects funded by the U.S. government impact firms in your riding? Did such firms pressure the government in negotiating the resulting agreement? On balance, do you think that more open bilateral procurement would help or hinder firms in your district?
2. Is free trade in government procurement resulting from economic stimulus measures realistic? Should taxpayers have the expectation that money spent on economic stimulus measures be used to bolster the domestic economy? Are there any Buy Canadian provisions in stimulus program spending?
3. Given the reluctance of Canadian provinces to sign on to the AGP in the past, what role did the initial exclusion of Canadian firms from certain stimulus funding play in changing the game? Did the provinces have other reasons for reexamining their participation in the AGP?

U.S. Imports of Canadian Softwood Lumber⁶⁰

Issue Definition

The U.S. lumber industry has long argued that imports of subsidized Canadian lumber were injuring U.S. producers. In May 2002, after the U.S. lumber industry filed antidumping and countervailing petitions to restrict imports, agency determinations of Canadian subsidies, dumping, and injury to the U.S. industry led to a duty of 27% (later reduced) on most Canadian softwood lumber imported into the United States. Canada challenged these findings under NAFTA and before the WTO. Negotiations led to a seven-year Softwood Lumber Agreement in 2006 with Canadian export charges depending on U.S. lumber prices, and the United States revoked the countervailing and antidumping orders. On February 26, 2009, a tribunal found that four Canadian provinces had violated the Agreement in calculating 2007 quotas; the United States rejected the Canadian offer of compensation, and on April 15, 2009, the United States began collecting 10% *ad valorem* duties from the four provinces to compensate for the 2007 breach.

Background and Analysis

U.S. lumber producers have long expressed concerns about imports of subsidized Canadian lumber. The current lumber agreement is termed Lumber IV, because it is the result of the fourth dispute since 1981, with various findings of subsidy levels and agreements in the previous disputes.

Tension between the United States and Canada over softwood lumber trade may be inevitable. Both countries have extensive forest resources, but vastly different population levels and development pressures; vast stretches of Canada are still largely undeveloped, while less area in the United States (outside Alaska) remains relatively pristine. These differences have led to divergent forest policies. In Canada, 90% of the forests are owned by the provincial governments, which have allocated and priced timber to encourage development of the extensive timber reserves and settlement of unpopulated areas. In the United States, 58% of timberlands are privately owned, and private markets dominate the allocation and pricing of timber. U.S. federal and other government-owned forests are regionally important, but the timber is typically sold in a competitive market.

U.S. lumber producers assert that subsidies have given Canadian producers an unfair advantage in the U.S. market. Canadian provincial stumpage fees (for the right to harvest trees) are asserted to be subsidized, leading to lumber prices that are less than their fair market value. The provinces generally use leases and administered fees to allocate and price timber. Administered fees are unlikely to match market values, but determining whether the fees are below market values has been controversial, because of differences in tree species, sizes, and grades; in measurement systems; in requirements on harvesters; in environmental protection; and in other factors.

Log export restrictions in British Columbia are also alleged to be subsidies, because they assure more supply (less competition for timber and thus lower costs) for Canadian producers. Evidence

⁶⁰ Prepared by Ross W. Gorte, Specialist in Natural Resources Policy, Resources, Science, and Industry Division, and Jeanne J. Grimmett, Legislative Attorney, American Law Division.

from the U.S. Pacific Northwest, where private logs can be exported but public timber cannot, indicates substantially higher prices for exported logs.

Injuries to U.S. lumber producers are difficult to establish decisively, although the U.S. International Trade Commission (ITC) has found injury every time it has examined the issue. Canada's share of the U.S. lumber market has risen substantially, from less than 7% in the early 1950s to more than 33% since the mid-1990s. Under the 1996 agreement, the quantity of imports continued to rise, but the market share was relatively stable. The impact of restrictions on U.S. lumber prices is not easily estimated, but restrictions have probably put upward pressure on prices.

Status of the Issue

In 2001, after the 1996 U.S.-Canada softwood lumber agreement expired, the U.S. Coalition for Fair Lumber Imports filed countervailing duty and antidumping petitions, asking the DOC to investigate Canadian imports again. The Department of Commerce issued final determinations of subsidies on March 22, 2002. On May 3, 2002, the ITC determined that the U.S. lumber industry was threatened with material injury by Canadian imports. A duty averaging 27% was imposed on May 22, 2002.

Canada challenged each of the agency determinations under the North American Free Trade Agreement (NAFTA) and in the World Trade Organization (WTO). The NAFTA panels largely supported the Canadian positions. The WTO proceedings resulted in mixed decisions. Canada was also concerned that the US\$5 billion in estimated duties on softwood lumber collected by the United States would eventually be distributed to U.S. lumber producers under the Continued Dumping and Subsidy Offset Act (Byrd Amendment). Canada obtained a U.S. court decision, however, holding that the Byrd Amendment did not apply to Canadian lumber imports.

On April 26, 2006, a tentative seven-year Softwood Lumber Agreement, with an optional two-year renewal, was announced to resolve the dispute. The United States revoked the countervailing and antidumping duty orders and returned about US\$4 billion to the importers of record. The remaining deposits (about US\$1 billion) were split evenly between the members of the Coalition for Fair Lumber Imports and jointly agreed-upon initiatives. Canada is collecting export charges ranging up to 15%, depending on a weighted average lumber price, or up to 5% with volume restraints. A surge mechanism would raise export charges if a Canadian region's exports exceed its allocated share. Lumber from logs harvested in the Atlantic Provinces, Yukon, Northwest Territories, or Nunavut is exempt from the export charges. Disputes are to be resolved through bilateral consultations, non-binding mediation, or binding arbitration in the London Court of International Arbitration (now LCIA).

U.S. interest groups have questioned whether Canada is faithfully implementing the agreement. The 2008 farm bill (P.L. 110-246) included a provision (§3301) establishing a softwood lumber importer declaration program to verify and reconcile data on softwood lumber imports. In August 2007, U.S. officials requested a ruling from the London Court of International Arbitration (LCIA) on export quota volumes and export tax levels. In March 2008, the Court ruled that Canada had violated the export quota volumes for Manitoba, Ontario, Québec, and Saskatchewan for the first six months of 2007, but was not required to collect taxes related to export surges from Alberta and British Columbia during that period. To comply with the above ruling, an LCIA tribunal issued a decision that Canada must collect an additional 10% *ad valorem* export charges from the four provinces until C\$68.26 million (US\$54.8 million) had been collected on February 26, 2009.

The U.S. Trade Representative rejected the Canadian offer of a compensation payment of US\$36.66 million, and on April 15, 2009, began collecting 10% duties on lumber from the four provinces.

Questions

1. The current dispute over U.S. imports of Canadian lumber has persisted for nearly 30 years. Do Canadian producers have a significant cost advantage because of Canadian timber practices and/or subsidies? Should Canadian practices be modified to enhance competition for timber? Do the systems and situations vary sufficiently to warrant different responses to each Canadian province? What might be the environmental consequences of various possible changes?
2. The 2006 agreement terminated the duties, returned most of the money collected, and established price-dependent export charges on Canadian lumber. What changes are needed by 2013 to assure that the recent duties, challenges, and litigation are not repeated when the agreement expires? What happens if some of the provinces make appropriate changes and others do not?
3. Are the current oversight mechanisms sufficient to assure implementation of the agreement that is acceptable to all parties? Are there ways to provide adequate and timely data to identify possible violations (deliberate or unintentional) and thus the delay and cost of arbitration and subsequent remedies? What approaches are feasible to compensate communities and workers for injury from weak lumber markets without providing subsidies to the lumber industry? What unilateral U.S. enforcement measures might be acceptable to Canada under the agreement?

Black Liquor⁶¹

Issue Definition

Tax incentives for renewable energy are often seen as necessary to encourage deployment and adoption of what are newly developed technologies and processes. With renewable biofuels, the concept also extends to considerations of displacing the use of existing fossil fuels so as to reduce the greenhouse gas emissions associated with global climate change. The production of renewable biofuels are not without controversy, as environmentally beneficial choices and solutions are still being debated. While black liquor is generally seen as meeting U.S. requirements for renewable electricity, how it can meet requirement for use as a renewable fuel is still a question.

Background and Analysis

Paper companies in the United States can no longer claim a biofuel tax credit of \$1.01 per gallon for the use of “black liquor” that would have been allowed under the 2008 Farm Bill. An amendment was added to the Health Care Bill (P.L. 111-148) which disqualified black liquor from eligibility. Congress acted to exclude black liquor from an estimated \$24 billion in tax

⁶¹ Richard Campbell, Specialist in Energy Policy. Resources, Science, and Industry Division.

credits after news of a memorandum from the Internal Revenue Service emerged indicating that the industry may be able to qualify black liquor for the credit. Eligibility for black liquor under the biofuel credit had been uncertain prior to congressional action. Congress also moved to exclude “tall crude oil” from the biofuel tax credit. Tall crude oil is made by skimming the top layer from black liquor and adding acid. The resulting product can be used by pulp and paper companies as fuel, or is sold to others as a base for paint or print ink.

Black liquor is a waste product from the paper production process comprised of mostly organic lignin and inorganic pulping chemicals, and has long been used in the pulp and paper industry as a source of energy. The pulping chemicals dissolve the lignin bonds holding together the cellulose fibers in pulped wood, allowing these fibers to be made into paper products. While some paper producers burn the black liquor directly, the waste is often processed in specialized boilers which burn the organic components and allow the inorganic chemicals to be recovered from a smelt for reuse in the pulping process. The heat from burning the black liquor is then used to make steam for thermal processes in a paper mill, and can also produce electricity for the mill in combined heat and power applications.

The organic components of black liquor can theoretically be gasified used to produce syngas, from which other higher value products and chemicals, such as dimethyl ether (a potential diesel substitute) can be made.

Status of the Issue

Companies in the U.S. pulp and paper industry have been taking advantage of an existing alternative energy tax credit of \$0.50 per gallon which allowed renewable fuels to be added to fossil fuels thus reducing the proportion of fossil fuels in energy production. By mixing diesel fuel and black liquor, companies in the pulp and paper industry were estimated to have benefited by as much as \$6 billion. The alternative energy tax credit expired at the end of 2009.

Firms in the Canadian pulp and paper industry had seen the alternative energy tax credit as an unfair subsidy to the U.S. pulp and paper industry, even though the program was clearly not created or intended for an industry-specific subsidy.

Questions

1. Will the action by Congress to terminate the tax credit for biofuel eligibility for black liquor affect the prospect of developing gasification as a technical option for black liquor especially as regards future biofuels consideration?
2. Is there a potential for filing of complaints under applicable trade agreements between the United States and Canada with regard to the expired alternative energy tax credit?

Country of Origin Labeling⁶²

Issue Definition

Mandatory country-of-origin labeling (COOL) for specified agricultural products took effect on March 16, 2009. This is the culmination of a near decade-long legislative effort to arrive at an accommodation that addresses the concerns of competing interests. Food retailers are now required to label the country of origin for fresh produce (fruits and vegetables), meats, nuts, and seafood, among other products. Canada and Mexico are major suppliers of live cattle and hogs that are fed in U.S. facilities and/or processed into beef and pork in U.S. meat packing plants. As the U.S. meat processing sector geared up to implement COOL, Canadian cattle and hog exports to the U.S. market noticeably declined. Both countries expressed concern that this development adversely affected their livestock sectors. Not satisfied with the outcome of consultations held with U.S. officials on their concerns, both Canada and Mexico in November 2009 requested the establishment of a World Trade Organization (WTO) dispute resolution panel to consider their case.

Background and Analysis

Under the Tariff Act of 1930, as amended, most unprocessed agricultural commodities have long been exempt from requirements that every import be clearly marked to indicate country of origin for the “ultimate purchaser.” However, provisions in the 2002 farm bill (section 10816 of P.L. 107-171) require that retailers covered by the Perishable Agricultural Commodities Act (i.e., those which deal in at least \$230,000 per year in produce—fresh and frozen fruits and vegetables) begin to provide such information. Other covered commodities specified in the 2002 farm bill were: ground and muscle cuts of beef, lamb and pork; seafood; and peanuts. Labeling is not required if these commodities are ingredients in processed foods, or if they are sold in dining out settings.

Passage of the initial COOL provisions in 2002 did not end debate over the value and efficacy of mandatory COOL, particularly with regard to meats. COOL opponents argued that record-keeping and verification costs will far exceed any perceived economic benefits to producers; that smaller-sized farms and firms will have the most difficulty with compliance; that there is little evidence consumers actually want labeling; and that COOL is a protectionist policy that undermines free trade. Supporters countered that compliance would not be nearly as burdensome as some large industry groups and USDA have portrayed it; that studies show U.S. consumers, if offered a clear choice, will pay extra for fresh foods of domestic origin, thereby strengthening demand and prices for them; and that consumers have a right to know where their foods were produced. They pointed out that all but two of the North American cases of “mad cow” disease (*bovine spongiform encephalopathy*, or BSE) occurred in Canadian-born cattle, yet the United States is permitting the import of large quantities of Canadian beef and cattle. (COOL opponents argue that country of origin labeling is a matter of marketing, not food safety, and that food safety concerns are best addressed through science-based regulation.)

⁶² Prepared by Remy Jurenas, Specialist in Agricultural Policy, Resources, Science and Industry Division.

Initially scheduled to take effect on September 30, 2004, Congress postponed COOL implementation until September 30, 2008 for all but seafood, because of ongoing debate. Some issues were addressed in talks held among key players during consideration of the 2008 farm bill. Compromises struck were incorporated into section 11002 of P.L. 110-246. These provisions retained the implementation schedule, and added other commodities (chicken, goat meat, ginseng, pecans, and macadamia nuts) to its coverage. However, several new types of label categories were created that are intended to facilitate and simplify compliance in specifying the country or countries of red meat products. For all covered commodities, the amended law also seeks to ease recordkeeping and verification requirements, and to lower non-compliance penalties.

Canada is the leading source of U.S. food and agricultural imports, accounting for about 20% of total import value. Its importance as a source reflects the close and growing economic integration of the two countries' markets. Many of these imported products are now covered by mandatory COOL. The Canadian government argued for some time that COOL is a protectionist measure, and has initiated a formal complaint challenging it as trade distorting under existing trade agreements.

Status of the Issue

Enactment of the amended COOL provisions allowed USDA to proceed to issue rules to implement them. The August 2008 interim rule for meat labeling requirements generated the most controversy, in large part because of the steps that U.S. feeding operations and packing plants would have to adopt to segregate, hold, and slaughter foreign-origin livestock from U.S. livestock. Concerned with apparent changes in normal livestock trade flows in reaction to the proposed rules and questioning COOL's legality under trade rules, Canada on December 1, 2008 filed a request for formal WTO consultations on COOL with the United States. Bilateral consultations were held twice, but failed to resolve differences. On October 7, 2009, Canada requested the establishment of a WTO dispute settlement panel to look into its claims. On November 19, 2009, the WTO agreed to establish a panel to examine this and Mexico's nearly identical case on COOL. A decision by the dispute panel is likely no earlier than mid-2011 due to the slow pace in the naming of its members.

Canada in its filing asserts that COOL is inconsistent with several WTO-related trade commitments, including those providing that imports must be treated no less favorably than products of domestic origin; that laws on marks of origin should not damage imports, reduce their value, or unreasonably increase their cost; and that laws, rules, and procedures on country of origin should not "themselves" create or disrupt international trade. Canadian officials stated that the COOL requirements are "so onerous" that when implemented, Canadian exporters of cattle and hogs were discriminated against in the U.S. market. U.S. officials regretted that the consultations did not resolve Canada's concerns, and stated their belief that U.S. implementation of COOL provides consumers with information that is consistent with WTO commitments. They noted that countries had agreed that country of origin labeling was legitimate policy long before the WTO was created, and that other countries also require goods to be labeled with their origin. In December 2009, 25 senators wrote to Obama Administration officials to express their support for implementing COOL according to congressional intent, stating that the program is nondiscriminatory in its requirements that both domestic and imported goods be labeled with their origin. They also noted that 45 other countries (including Canada and Mexico) implement programs that provide country of origin information to consumers. (letter available at the website of Senator Mike Enzi, <http://enzi.senate.gov>)

Questions

1. Reports in meat trade publications have suggested that the final COOL requirements have strained marketing relationships between Canadian and U.S. livestock producers and meat processors. How much has this tension altered trade between the United States and Canada, and, if so, in what way? What economic adjustments if any have occurred in light of the decrease in Canadian hog and cattle exports to the United States?
2. In general, how will COOL likely affect the composition and economic viability of both the cattle/beef and hog/pork sectors in North America?
3. How does Canada's country of origin labeling program for food products compare to that implemented under the U.S. COOL program ?

The Canadian Auto Sector⁶³

Issue Definition

In 2009, the governments of the United States, Canada, and the Province of Ontario were faced with the bankruptcy of General Motors (GM) and Chrysler, major employers on both sides of the border. All three governments provided financial assistance to these two automakers to facilitate their restructuring. These government investments in GM and Chrysler sustained the companies so they could exit bankruptcy to regain their footings as global automakers. Along with Ford's own, separate private restructuring, these actions of the Detroit 3—GM, Ford and Chrysler—are reshaping the Canadian auto market.

Background and Analysis

The U.S. and Canadian automotive industries have been highly integrated for decades. The landmark U.S.-Canada Automotive Products Trade Agreement of 1965 (also known as the Auto Pact) was one of the first sectoral free trade agreements, allowing automotive vehicles and parts to move duty-free across the border. The Auto Pact, which guaranteed that for every five cars sold in Canada, three would be assembled there, boosted car production in Canada, making it the largest manufacturing sector in that country, displacing the paper and pulp industry. The elimination of tariffs allowed U.S. auto companies to build plants on both sides of the border that were large enough to serve both countries efficiently.

The Auto Pact shaped U.S.-Canadian auto trade until it was superseded by the U.S.-Canada Free Trade Agreement (CUSFTA) in 1989 and the North American Free Trade Agreement (NAFTA) in 1994. NAFTA's major contribution to auto trade was to bring Mexico into the relatively open Canada-U.S. auto production market and to tighten rules of origin pertaining to North American content requirements. After each of these agreements went into effect, coordinated production on both sides of the border increased, as did bilateral automotive trade.

⁶³ Prepared by Bill Canis, Specialist in Industrial Organization & Business; Resources, Science, and Industry Division.

The Canadian auto industry produced 1.5 million vehicles in 2009, down from annual production of over 2 million vehicles in 2008 and earlier, due to the recession. It was the 11th largest auto-producing nation in 2009, slightly larger than the United Kingdom (1.1 million vehicles) and smaller than Mexico (1.6 million). As an economic recovery begins, production in 2010 is forecast to reach 1.9 million vehicles and then about 2.1 million vehicles a year in 2011-2015, according to IHS Global Insight.

In 2009, auto sales in Canada were 1.5 million units, down from 1.6 million units in 2008. According to *Automotive News*, the Detroit 3's share of sales fell from 50% in 2008 to 45% last year. Sales from Japanese companies rose from 35% to 39%; sales of European models fell from 9.3% to 8.3%, while Korean vehicles rose from 5.7% to 7.0%.

In 2009, the auto industry produced 14% of Canada's manufacturing output and accounted for 23% of its manufactured exports, according to Industry Canada, a government agency. It is by far Canada's largest industrial sector. Last year the auto industry in Canada employed 150,000 people directly, and 340,000 indirectly, including parts suppliers and auto dealers. Nearly a fifth of General Motors (GM), Ford, and Chrysler's North American production capacity is in Canada, principally in Ontario. In 2009, of the 1.5 million light vehicles produced in Canada, IHS Global Insight notes that the Detroit Three accounted for 59%—approximately 22% by GM, 16% Ford, and 21% Chrysler. Moreover, the automotive parts market, or so-called aftermarket, is reportedly the largest retail sector in Canada, ahead of clothing, food, furniture, and pharmaceuticals.

The Detroit 3's Canadian facilities are unionized, while Toyota and Honda have assembly plants in Ontario that are non-union. The Japanese transplants have a lower cost structure than the Detroit 3, in part because of long-standing wage differentials. This may be changing. A 2007 contract and 2009 amendments to that contract negotiated between GM and Chrysler and the UAW (and its Canadian counterpart, the Canadian Auto Workers, CAW) represented a major break from past labor agreements and may, in time, achieve greater wage parity between the domestic and foreign-owned manufacturers. Workers at GM and Chrysler also agreed not to strike until 2015. (Ford employees are covered by a different contract.)

In late 2008, the U.S. and Canadian auto industry—along with Europe and Japan—was caught in a global economic recession and credit crisis that caused auto sales to fall sharply. General Motors and Chrysler turned to the U.S. and Canadian governments for assistance in the final months of 2008. In December 2008, President Bush announced a plan to loan \$17.4 billion to GM and Chrysler to prevent any near-term bankruptcy and to help them restructure as more viable and competitive companies in the long run. On the following day, the Canadian government and province of Ontario responded to the U.S. auto bailout by pledging \$3.3 billion in emergency loans to the local subsidiaries of GM and Chrysler.

In March 2009, the U.S., Canadian and Ontario governments announced that they were rejecting the two automakers' viability plans and requests for further assistance, giving GM 60 days and Chrysler 30 days to revise their plans and forge agreements with all stakeholders. They were unable to get all creditors to agree and so both companies filed for bankruptcy, with new entities being incorporated in the summer of 2009, leaving many liabilities and some assets behind in bankruptcy. GM shed several of its brands, including Pontiac which accounted for as much as 25% of its sales in Canada.

The other Detroit 3 automaker, Ford Motor Company, did not seek or receive government financial assistance because it had independently restructured the company and refinanced its

debt before the recession and credit crisis. The changes it made in its operations are widely considered to have been as equally extensive as GM's and/or Chrysler's.

Status of the Issue

GM and Chrysler went through an expedited bankruptcy, just over 40 days for each company. Because the credit markets were still tight in 2009, the only source of financial aid for them through the bankruptcy proceedings was support from the U.S., Canadian, and Ontario governments. Had these governments not provided financing, it is likely that both companies' assets would have been liquidated during bankruptcy and the assets sold to the highest bidders.

The U.S. government has provided \$50.8 billion to GM and \$12.8 billion to Chrysler, through the Troubled Asset Relief Program (TARP). The Canadian government and the government of Ontario provided loans of \$3.02 billion to Chrysler and \$9.5 billion to GM. All of these governmental loans were converted into a mix of equity and loans. The governments received these equity stakes in the companies: the U.S. government owns 60.8% of GM and 9.85% of Chrysler; the Canadian and Ontario governments own 11.7% of GM and 2.46% of Chrysler. In addition to these equity holdings, GM had loans of \$6.7 billion from the U.S. Treasury and \$1.4 billion from Canada. Although not due until 2014, GM paid off these loans in April 2010. The three governments may recoup the rest of their investment in GM after it issues an initial public offering (IPO) later this year. Chrysler has not repaid its loans and is not likely to offer an IPO before 2012.

Questions:

1. Will the Detroit 3 automakers—GM, Ford and Chrysler—be successful in Canada now that they have each restructured? Will they be able to add to their current 59% share of Canadian production?
2. While General Motors has repaid an outright loan to the U.S., Canadian, and Ontario governments, how will these same governments fare when they seek to sell their ownership stakes after GM issues after an expected IPO later this year?
3. Hyundai-Kia's share of the Canadian market has grown in recent years, while the South Korean market remains largely closed to North American-built vehicles. How will this sales trend affect Canada's interest in a proposed free trade agreement with South Korea?

The Canadian Steel Sector⁶⁴

Issue Definition

The impact of the global economic downturn and the financial crisis that erupted in the summer of 2008 has had substantial negative effects on most manufacturing industries, including the North American steel industry. An earlier slump in steel, which occurred in the 1990s, led to

⁶⁴ Prepared by Rachel Tang, Analyst in Industrial Organization & Business; Resources, Science, and Industry Division.

numerous bankruptcies and takeovers of many U.S. and Canadian steel makers. Almost all of the major steel makers in Canada are now foreign owned, so decisions to close or idle plants or reduce production in Canada (but not elsewhere), inevitably affect national economic and political interests.

Pittsburgh-based U.S. Steel moved to idle many of its Canadian operations in 2009 when steel orders fell precipitously. The Canadian government, the United Steel Workers, and local steel manufacturer(s) took legal actions against it under the Investment Canada Act. The Canadian government alleges that U.S. Steel is not abiding by commitments it made under the act when it acquired the Canadian steelmaker, Stelco, in 2007. Legal proceedings are ongoing.

Background and Analysis

During the 1990s and the first decade of the 21st century, many U.S. and Canadian steel companies experienced a downturn that led to a major restructuring and reorganization of the North American steel industry. In 2009, the Canadian steel industry looks very different than it did in 2000. The major integrated steel producers, including Dofasco, Stelco, and Algoma Steel, are now owned by international companies. Dofasco was acquired by Luxemburg-based Arcelor in 2006. At about the same time, Arcelor agreed to merge with Mittal Steel of Rotterdam. Dofasco is now a subsidiary of ArcelorMittal, the world's largest steelmaker. In 2006, Mittal Steel acquired several Stelco subsidiaries and U.S. Steel purchased the remaining part of Stelco, which was renamed U.S. Steel Canada Inc. Algoma Steel was purchased by Essar Steel of India in 2007, and operates as Essar Steel Algoma Inc.

The Canadian minimill steel sector also went through a restructuring process. Minimills produce steel from scrap metal in electric arc furnaces (EAFs). In 2002, the Canadian firm, Co-Steel, merged with Ameristeel, the North American subsidiary of Gerdau S.A., of Brazil. Gerdau's North American operations were renamed Gerdau Ameristeel and are based in Tampa, FL. Gerdau Ameristeel is the second largest minimill steel producer in North America after U.S.-based Nucor. In 2008, Russia's Evraz Inc. S.A. acquired another major Canadian minimill steel maker, IPSCO Canada.

The North American steel industry struggled from 1997 through 2002. In March 2002, President Bush imposed safeguards in response to surging imports of steel. One goal of safeguards was to effect a restructuring of the domestic steel industry. To a great extent, that restructuring has been achieved. There are now two dominant players among integrated steel mill companies in the United States and North America, and two clear market leaders among the minimill producers. Moreover, the leading North American and global producer, Mittal Steel, in 2006 acquired the global number-two producer, Arcelor. The recovery of pricing power in the domestic industry may be attributable to industry consolidation, as well as to rising global demand spurred, in large part, by China. Ironically, the establishment of industry pricing power, plus the rise of global demand and steel prices and the falling exchange rate of the dollar, have also made establishment of new production facilities in the United States an attractive proposition. After the removal of safeguards, steel prices generally moved upward through August 2008, when the benchmark price of hot-rolled steel reached nearly \$1,200 per metric ton (MT) – up from \$222 per MT in 2002.

Starting in September 2008, the global economic crisis caused steel production and prices to fall precipitously. Like many other industrialized countries, the impact of market downturn was felt by all the major steel consuming sectors in Canada—automotive, construction, manufacturing,

appliance, and energy. Furthermore, given the overall difficult economic environment, the steel export market was also lackluster.

In 2009, the United States, Canadian steel's biggest export customer, suffered a major setback: U.S. crude steel production dropped more than 36% from the 2008 production level to 58 million metric tons, with steel mills running at a capacity utilization rate slightly over 50%. During the first half of 2009, the overall capacity utilization rate in U.S. steel mills lingered in the low to mid-40% range.

Canadian steel production also experienced a sharp drop in 2009, to approximately 9 million MT of crude steel, nearly 40% less than the 15 million MT produced in 2008. In 2009, steel-making capacity utilization rate in Canada was about 43%. Pittsburgh-based U.S. Steel moved to idle much of its Canadian operations in March 2009, largely because of low demand for steel. Affected U.S. Steel plants in Canada included the flat-rolled steel plant in Hamilton, Ontario, known as the Hamilton Works, and Lake Erie Works in Nanticoke, Ontario. Some of its U.S. operations were also affected by the crisis. U.S. Steel met strong resistance from the Canadian government and the local United Steelworkers union (USW), which raised questions about why more facilities in Canada were affected than in the U.S. On May 5, 2009, Canadian Minister of Industry, Tony Clement, sent a demand letter to U.S. Steel under Section 39 of the Investment Canada Act (ICA), asking the company to comply with its undertakings (its alleged contractual commitments):

When U.S. Steel acquired Stelco Inc. in 2007, it committed to a series of undertakings regarding, among others, capital expenditures, research and development and production," Mr. Clement said. "I am concerned by the actions of U.S. steel in cutting operations in Canada and by the impact this have on its workers. While I recognize that these are challenging economic times, we expect the company to live up to its commitments.

A demand letter is the first step in the enforcement process under the Investment Canada Act. If a company is found in violation of the act, it could be forced to sell its Canadian operations or pay fines of C\$10,000 per day. U.S. Steel had 10 days to respond to the letter, but noted that "since all of the communications between the Minister and U.S. Steel on this subject are required to be confidential under the Investment Canada Act, we cannot comment on the substance of those communications." (*American Metal Market*, "Canada taking USS to court over closings," July 20, 2009.)

In July 2009, after reviewing U.S. Steel's response, the Canadian government took U.S. Steel Corp. to the Federal Court of Canada, asking the Court to order appropriate measures to remedy the situation.

Status of the Issue

U.S. Steel moved to file a challenge to the Investment Canada Act (ICA) in November, 2009, claiming that certain provisions of the law violate its constitutional rights. Among them is the stipulation that companies that fail to comply with promises made under the ICA must pay fines or must divest their assets, but are not given a chance to mount a proper defense. It also argued that the penalty of C\$10,000 a day was akin to criminal punishment. The Canadian government is seeking the dismissal of U.S. Steel's challenge and "is trying...to force U.S. Steel to either operate its Canadian assets or sell them to a party that will operate them." (*American Metal Market*, "Canada fights USS legal challenge," December 15, 2009.)

On April 15, 2010, U.S. Steel Canada announced that USW Local Union 8782 had ratified a three-year labor contract for employees at U.S. Steel Canada's Lake Erie Works. The deal will allow U.S. Steel to restart production at the facility based on improving steel demand. Production at Hamilton Works had restarted earlier. On April 28, 2010, U.S. Steel Canada announced that it has entered into an agreement to sell its bar mill and bloom and billet mill at its Hamilton Works to Max Aicher (North America) Inc., a wholly owned subsidiary of Max Aicher GmbH & Co. KG of Germany. Max Aicher had previously entered into talks to purchase the bar and bloom mills in 2007, prior to their purchase by U.S. Steel. The transaction is subject to government approval and other unspecified conditions.

Questions:

1. To what extent can American investors be assured that economic and market conditions that affect their Canadian businesses will not be subject to legal action under the Investment Canada Act?
2. With the significant restructuring of the North American steel sector after 2002 and the collapse of global steel markets in 2008 and 2009, should the U.S., Canadian, and Mexican governments begin discussions on a common steel policy that will protect the North American market from import surges?
3. Do you believe that the Investment Canada Act is working appropriately? Does the perception that an act regulating foreign investment is a tool of industrial policy cause you any concern?

Intellectual Property Rights⁶⁵

Issue Definition

The United States contends that Canada's protection and enforcement of intellectual property rights (IPR) are inadequate and do not meet international standards. Trade in IPR-infringing products within Canada and the transit of such goods through Canada may have negative commercial, health, safety, and other consequences. Some U.S. pharmaceutical manufacturers, regulators, and other groups have expressed concern about the diversion of prescription drugs from Canada into the United States in cases where the drugs may be sold legally in Canada but are not approved for sale in the United States by the U.S. Food and Drug Administration (FDA). Areas of bilateral engagement on IPR include Canada's reform of its copyright regime, lack of implementation of the World Intellectual Property Organization (WIPO) Internet treaties, and enforcement system.

Background and Analysis

Protection and enforcement of IPR is important to bilateral relations because of the high levels of trade between the United States and Canada. Bilateral commitments on IPR exist in the North

⁶⁵ Prepared by Shayerah Ilias, Analyst in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

American Free Trade Agreement (NAFTA). As members of the World Trade Organization (WTO), both countries are signatories to the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which sets minimum standards for IPR protection and enforcement. Presently, Canada and the United States are among the nearly 40 countries negotiating the Anti-Counterfeiting Trade Agreement (ACTA), a new international agreement which would build on the TRIPS Agreement.

Special 301 Watch List

In 2010, the Office of the U.S. Trade Representative (USTR) again placed Canada on its Special 301 “Priority Watch List” (PWL), a designation of criticism for a country’s inadequate IPR protection and enforcement. The USTR cited ongoing issues with Canada’s copyright reform and IPR enforcement efforts at the border. USTR first placed Canada on the PWL in 2008, and before then, since 1985, Canada had been on the “Watch List,” the mildest category of criticism for a country’s IPR regime. Some supporters of Canada’s IPR regime assert that the Special 301 process is overly industry-driven and that Canada’s piracy rates are significantly lower than those of other countries on the PWL. Others, including some industry groups, maintain that placement of Canada on the PWL is a genuine reflection of the inadequacies of Canada’s IPR regime.

WIPO Internet Treaties

The WIPO Copyright Treaty and the Performance and Phonograms Treaty (the “WIPO Internet treaties”) set minimum standards, agreed upon internationally, for IPR protection and enforcement in the digital environment. Canada ratified the WIPO Internet treaties in 1997, but remains one of few developed countries that has not brought its laws into compliance with the treaties. The United States implemented the WIPO Internet treaties in 1998 through the Digital Millennium Copyright Act (DCMA) (P.L. 105-304), and has called on Canada to implement an equivalent of the DCMA.

Copyright Legislation Reform

Since Canada’s ratification of the WIPO Internet treaties in 1997, the Canadian government periodically has attempted to overhaul its domestic copyright regime. Some copyright-based industry and other groups assert that Canada does not sufficiently combat online piracy or the circumvention of technological measures that protect copyrighted works. Some maintain that, in addition to focusing on commercial piracy, Canada also should prosecute retail piracy, which takes place on a smaller scale but can still contribute to significant copyright losses. Others, including consumers and Internet service providers, express the need to reform copyright law in a way that balances the interests of both copyright. For instance, some argue that it is important to protect “fair use” (exceptions to copyright for educational, research, and other purposes) to promote the free flow of information and innovation.

In June 2008, a Copyright Amendment Act (C-61) was introduced in the House of Commons, although it was not acted on before the dissolution of the 39th Parliament. Among its provisions, the bill would have implemented the WIPO Internet treaties by updating the rights and protections of copyright owners in a digital environment and clarifying the liability of Internet service providers. From July 2009 through September 2009, the Canadian government conducted public consultations online and through town hall meetings on proposed reforms to Canada’s copyright laws. While some applaud the government for consulting with public sector groups,

others argued that the consultations were not representative of Canadian demographics and lacked transparency and accountability. Copyright reform legislation is expected to be reintroduced in the 40th Parliament this year.

Enforcement

Presently, the Canada Border Services Agency (CBSA) is not authorized to seize products at the border that are believed to be pirated or counterfeit without a court order, which requires detailed information. Some contend that this lack of authority limits the effectiveness of IPR enforcement in Canada.

Enforcement within Canada is led by the Royal Canadian Mounted Police (RCMP) and local police, which do not have sufficient IPR resources, expertise, and staff, according to the Canadian Anti-Counterfeiting Network. In addition, IPR enforcement competes with many priorities for the RCMP. IPR-infringement prosecutions are believed to be rare because of a lack of legal professionals dedicated to IPR and a lack of technical expertise. The United States contends that the enforcement penalties imposed by Canada do not serve as sufficient deterrents for future IPR infringement.

Access to Medicines

Through Canada's Access to Medicines Regime (CAMR), Canada was one of the first countries to adopt a WTO framework that allows eligible developing countries with insufficient manufacturing capacity to import generic versions of patented drugs or medical devices, subject to various WTO notification, quantity, and safeguard requirements. Since its implementation in 2004, Canada has utilized the CAMR three times to issue a compulsory license for the production of an anti-retroviral HIV/AIDS drug combination by a Canadian-based generic drug manufacturer for export to Rwanda. While some contend that the CAMR is an effective, efficient framework for increasing access to medicines in developing countries, others criticize the notification and other regulatory requirements as excessively burdensome.

In order to increase U.S. access to more affordably-priced medicines, the 111th Congress introduced several bills that would allow Americans to import prescription drugs from foreign countries for personal use. Although debated, no such provisions were included in the final health care legislation (P.L. 111-148, P.L. 111-152). If such provisions were passed, Canada likely would be a leading source of parallel imports of prescription drugs. While some U.S. consumers and other groups support parallel importation on the basis that it allows Americans to access less expensive drugs, others argue that it does not address issues in U.S. pricing of drugs. Others, including some drug manufacturers and regulators, raise health and safety concerns. From the Canadian perspective, some argue that U.S. importation of Canadian drugs may reduce the supply of medicines, leading to higher prices in Canada.

Questions

1. What issues have arisen in developing legislation to implement the WIPO Internet treaties? What is Canada's vision of a fair and balanced copyright law? How could Canada's implementation of the WIPO Internet treaties differ from the U.S. DCMA?

2. What measures is Canada currently taking to address trade and transshipment of pirated and counterfeit goods? What steps can Canada undertake to improve IPR border and domestic enforcement? What can the United States do to assist Canada in improving IPR enforcement?
3. How does Canada view the U.S. Special 301 process? How does the Special 301 list and the elevation of Canada to the Priority Watch List in 2009 affect U.S.-Canadian relations? Does identification on the list affect Canadian IPR policy and future U.S.-Canadian engagement on IPR-related initiatives?
4. Estimating IPR infringement levels and the associated commercial impact can be challenging. The United States is working to improve its methodology and data collection efforts. Is Canada engaged in similar efforts and, if so, what are they?
5. What steps has Canada taken to promote international protection and enforcement of IPR? What are the opportunities and challenges that Canada sees in the ACTA?
6. How does Canada view the legislation proposed by the United States to allow the importation of drugs from Canada?

Electric Reliability, Trade, and Access to Renewable Power⁶⁶

Issue Definition

The electric power grids of the United States and Canada are physically connected. Consequently, electric power reliability problems can easily cross the international border. This was demonstrated by the 2003 power blackout, which originated in Ohio and eventually spread into eastern Canada and the northeastern United States. The United States and Canada are therefore mutually dependent for the reliable operation of their common electric power systems. The interconnected grid also creates opportunities for trade and joint expansion of the use of renewable power.

Background and Analysis

There are three components of electric power delivery: generation by power plants, transmission over long-distances by high voltage power lines, and final delivery at low voltage by distribution lines. The transmission lines that constitute the North American power grid cross state and international boundaries. The U.S. and Canadian grids are, in fact, inextricably linked:

- At the broadest level of organization, the North American grid is divided into regional “interconnections” within which power moves freely (the links between the regions are very limited). The large Eastern and Western Interconnections cover most of the contiguous United States and the heavily populated regions of Canada.

⁶⁶ Prepared by Stan Kaplan, Specialist in Energy and Environmental Policy.

- At the level of major transmission lines, the Canadian grid has evolved by building south from heavily populated areas to connect with U.S. generation and load. Consequently, while the grid in the conterminous United States is a web crisscrossing the lower 48 states, the Canadian backbone system consists of north-south lines closely linked to the United States. More electricity actually moves north and south between the United States and Canada than east and west between Canadian provinces.
- In terms of system reliability, as discussed further below, the North American Electric Reliability Corp. (NERC) has responsibilities for the reliable operation of the power grid in both countries. Three of the eight regional reliability entities through which NERC performs much of its work extend from the United States into Canada and cover that nation's entire southern tier.

Reliability

In reaction to the 2003 blackout, the Energy Policy Act of 2005 (P.L. 109-58) required the Federal Energy Regulatory Commission (FERC) to designate an Electric Reliability Organization (ERO) charged with ensuring the reliability of the bulk power system, largely by issuing mandatory reliability standards. In 2006 FERC selected NERC for this role (NERC is an industry organization whose reliability recommendations had been voluntary prior to its designation as the ERO). NERC's members include Canadian power companies and it has memoranda of understanding (MOU) with Canadian provinces and the Canadian federal government to help coordinate reliability activities. However, NERC does not have the same statutory authority in Canada as in the United States. The MOU between the Canadian National Energy Board (NEB) and NERC recognized NERC as the ERO for the Canadian part of international transmission lines but not for lines located entirely within Canada's borders (which are under provincial, not federal, regulation). NERC currently has agreements with most Canadian provinces that make, or will make in the future, NERC's reliability standards mandatory and enforceable.

Transmission capacity and congestion issues that can impair reliability and increase power costs exist in the United States and Canada, and the solution is often to construct new transmission capacity or enhance existing facilities. Many transmission projects are under construction or planned in both nations. However, transmission planning and construction in the United States and Canada face similar challenges, particularly for long-distance projects. These challenges include permitting and siting approvals that often involve multiple jurisdictions, and finding the funding for the large investments in transmission (and power generation) that will be needed to meet demand growth. Two international transmission projects of note include

- The planned Montana-Alberta Tie Line project, which would be the first transmission link between that state and province. This is a 214 mile, US\$213 million project that is expected to facilitate the export of wind power from both regions and improve transmission system reliability. The project is being partially financed by funding provided by the American Recovery and Reinvestment Act.
- A proposed high capacity transmission line to ship up to 1,200 megawatts of hydroelectric power from Québec to New England. Although this project has received preliminary approval from the U.S. Federal Energy Regulatory Commission, its future is uncertain because declining power prices in the United States (linked to low natural gas prices) may make the project uneconomical for the Canadian partner in the venture, the large utility Hydro-Québec.

Another Canadian project, the Northwest Transmission Line planned for northern British Columbia, may eventually connect southeastern Alaska to part of the Canadian power system.

Trade and Renewable Energy Development

United States is a net importer of electricity from Canada and the imports have recently been increasing, from 17.7 terawatt-hours (Twh) of net revenue purchases in 2006 to 32.2 Twh in 2008 and 33.2 Twh in 2009. From the U.S. perspective, while these imports can be locally important (e.g., in New York and New England), on a national basis they are very small, equivalent to 0.8% of total U.S. electric power generation (3,951 Twh) in 2009. Electricity trade is more significant from Canada's standpoint. Canada generated 575 Twh of electricity in 2009. Total revenue sales of power to the United States in 2009 of 51.1 Twh were therefore equivalent to 9% of domestic supply, and revenue purchases from the United States of 17.9 Twh were equivalent to 3% of domestic supply.

Electricity trade between the countries is likely to become intertwined with renewable energy development and transmission planning issues. Both nations currently have policies for the increased use of renewable power. The United States and Canada have established a "Clean Energy Dialogue" (CED) to facilitate the development of low carbon energy sources. Elements of the CED include, among other things, collaboration on: Expansion and modernization of the North American transmission grid to improve reliability and facilitate trade in low carbon power, advancement of smart grid technology, and development of electricity storage technology.

Canadian sources of renewable power may have the potential to reduce the need to build new, long-distance transmission projects (which can take up to a decade or more to permit and construct) in the United States. For example, imports of hydropower from Québec into New England and New York, using new but relatively short power lines, have been suggested by the transmission system authorities in those regions as an alternative to building power lines to Midwestern wind farms. However, as discussed above, one of these projects has been thrown into question by declining natural gas and power prices. Disputes at the state or provincial level can also complicate energy project development. An example is a recently-lifted moratorium established by the state government in Maine on the development of "energy corridors" for electric transmission and other facilities, including international power lines. The moratorium was established by Maine to protest the unwillingness of Canadian authorities to allow liquefied natural gas tankers to transit Canadian waters in order to reach a proposed terminal in Maine.

In the United States, the intersecting issues of renewable power development, transmission system expansion and reliability, and long-standing difficulties in multi-state permitting of new projects, has spurred suggestions for new regulatory and planning processes. The planning element of some proposals envisions creating transmission "master plans" on a wide geographic scope to facilitate renewable energy development and other purposes. While these proposals are limited to planning within the United States, they will inevitably have an impact on Canada because of the grid connections and the much larger size of the U.S. power system.

Status of the Issues

Reliability: NERC and FERC are continuing a process of developing and implementing mandatory reliability standards for the grid, with cybersecurity a growing concern. In Canada, the National Energy Board is reportedly working with provincial authorities on implementation of

mandatory reliability standards, although it is not clear if in all cases these will be the same as the NERC standards or whether NERC will function as the ERO in every province.

Trade and Renewable Energy Development: The 111th Congress is considering legislation that would create transmission planning and expedited permitting processes, aimed in large part at renewable energy development. The proposals could facilitate transmission development for enhancing reliability. In Canada, current efforts appear to be more focused on regulatory coordination than regional transmission planning.

Questions

1. Will Canadian federal and provincial regulators approve and enforce NERC electric reliability standards? Without identical standards in the United States and Canada, the reliability of the electric power system could be reduced.
2. Given that the United States and Canadian power grids are integrated, what steps should be taken to coordinate transmission planning (particularly if Congress enacts a new, federally mandated planning process)?
3. To what degree is Canada interested in exporting renewable power to the United States, or importing renewable energy from this country, rather than reserving these resources for domestic consumption?
4. How can the United States and Canada effectively resolve energy development issues that may involve both federal and state/provincial authorities?

U.S. Energy Security and Canadian Oil Sands⁶⁷

Issue Definition

Canada now ranks as the United States' number one source of imported petroleum and thus plays an increasing role in U.S. energy security. Canada's oil sands make up an increasing proportion of its petroleum production, and Canada's oil sands producers continue to look to the United States as the major market for their heavy oil exports. Of the 1.94 million barrels per day (mbd) of crude oil Canada exported to the United States in 2009, approximately 50% is delivered to the Midwest. This region's current capacity and planned refinery expansion places it in a position to receive increased heavy oil exports from Canada.

Although U.S. refinery capacity is forecast to increase from 17.6 mbd in 2010 to nearly 19.3 mbd in 2030—a 1.7 mbd increase, the deteriorating economics of the refining industry may bring these projections into question. In 2009-2010, the refining industry has been characterized by plant closures and divestiture. Actual, as well as projected, capacity expansion may not be enough to keep up with Canada's projected increase in oil sand production, especially if the investment climate continues not to warrant expansions to include upgrades for heavy oil processing. Canada is also pursuing additional refinery capacity for its heavier oil. Refinery expansions based on the

⁶⁷ By Robert Pirog, Specialist in Energy Economics, Resources, Science, and Industry Division.

use of heavy oils will have environmental effects, and Congress will continue to face controversy over the balance between energy security and the environment. In addition, investment and production plans are likely to be altered by the reduced demand for petroleum products associated with the ongoing effects of the economic recession that began in the last quarter of 2007.

Another possible impediment to expanded heavy oil use is Section 526 of the Energy Independence and Security Act of 2007 (P.L. 110-140) that prohibits federal procurement of an alternative or synthetic fuel “unless the contract specifies that the lifecycle GHG emissions are less than or equal to such emissions from the equivalent conventional fuel produced from conventional petroleum sources.” The provision is intended to ensure that federal agencies are not spending taxpayer dollars to promote new fuel sources that will exacerbate global warming, and would apply to fuels derived from “oil sands,” which are currently associated with producing higher greenhouse gas emissions than fuels derived from conventional, lighter crude oils.

Background and Analysis

When it comes to future oil supplies, Canada’s oil sands will likely make up a larger share of U.S. oil imports. Oil sands account for about 42% of Canada’s total oil production, and oil sand production is increasing as conventional oil production declines. Since 2004, when production from a substantial portion of Canada’s oil sands were deemed economic, Canada has been ranked second behind Saudi Arabia in proved oil reserves. Canada has over 178 billion barrels of reserves and a total of over 300 billion barrels of potentially recoverable oil sands (an attractive investment under high oil price conditions, demonstrated by the billions of dollars already committed to Canadian development). Canadian crude oil exports (from oil sands and conventional petroleum sources) were about 2 mbd in 2009, of which 99% went to the United States. Canadian crude oil accounts for about 21% of U.S. crude oil imports, and about 13% of all U.S. crude oil and petroleum products supplied. U.S.-based oil companies are major investors in Canadian oil sands. The infrastructure to produce, upgrade, refine, and transport oil from Canadian oil sand reserves to the United States is already in place. Oil sands production is expected to rise from its current level of 1.3 mbd to 3.6 mbd by 2030.

Greenhouse gas “emissions intensity” (CO₂/barrel) from oil sands are significantly higher than that from conventional oil production. Canada’s federal government classifies the oil sands industry as a large industrial air pollution emitter and expects it to produce half of Canada’s growth in greenhouse gas (GHG) emissions in 2010. Reducing air emissions is one of the most serious challenges facing the oil sands industry. Between 1995-2004, the oil sands industry reduced its emission intensity by 29% while oil production rose. Overall, CO₂ emissions have declined from 0.14 tons/barrel (bbl) to about 0.08 tons/bbl since 1990. However, Alberta’s GHG goals of 238 megatons of CO₂ in 2010 and 218 megatons CO₂ in 2020 are not expected to be met.

Status of the Issue

New refinery capacity that would accommodate heavier crude from Canadian oil sands is being challenged in Indiana, Michigan, South Dakota, and elsewhere. Some of these expansions or new refineries are several years away from operation. A BP refinery upgrade and expansion in Whiting, Indiana, expected to be completed in 2011, is progressing, but faces lawsuits from environmental groups. A new \$10 billion refinery in Union County, South Dakota, being planned to process heavy crude from oil sands, would be the first new refinery in the United States in over 25 years. Environmental groups continue to promote standards for low-carbon emission fuel and

oppose the permitting of these refinery projects on the basis that processing heavy crude from Canadian oil sands would generate much higher greenhouse gas emissions than from conventional petroleum sources.

Questions

1. What changes are necessary to significantly reduce the environmental footprint of heavy oil from Canadian oil sands?
2. How much capital investment in pipeline and refinery infrastructure is needed to support increased crude oil imports from Canada?
3. What would be the impact on U.S. federal and defense fuel procurements if Section 526 restrictions remain in place on fuel produced from Canadian oil sands?
4. After the drop in oil prices from over \$100 per barrel and the continuing effects of economic recession, how likely is it that Canadian oil sands development will be slowed because of revised investment strategies by the major oil companies?

Natural Gas Pipeline from Alaska⁶⁸

Issue Definition

Congress has been encouraging the development of large natural gas reserves discovered at Prudhoe Bay, Alaska for over 40 years. Principal among its policies has been promoting the construction of a natural gas pipeline from the Alaska North Slope to the lower-48 states. Beginning with the Alaska Natural Gas Transportation Act of 1976, and continuing through the Alaska Natural Gas Pipeline Act of 2004, the federal government has repeatedly affirmed a national need for an Alaska natural gas pipeline. The Obama Administration continues that support. In remarks to the press during his first month in office, President Obama described an Alaska gas pipeline as “a project of great potential”(as quoted by the Anchorage Daily News, February 11, 2009).

While it has been on the drawing board for decades, on and off, interest in an Alaska natural gas pipeline has recently revived because of accelerated growth in U.S. natural gas demand, price volatility in the natural gas market, and the increased importation of liquefied natural gas (LNG) from overseas. These factors have led legislators to restart the process of Alaska gas pipeline development. Important milestones in this activity were Alaska’s August 2008 award to TransCanada Pipelines Ltd., a Canadian company, of a license to build a natural gas pipeline from Prudhoe Bay to the lower-48 states and the concurrent announcement of a competing pipeline proposal along a parallel route. Because large sections of an Alaska natural gas pipeline to the lower-48 states would pass through Canada, the involvement of Canadian agencies would be essential for the pipeline’s success. However, Canada has been pursuing its own Arctic natural gas pipeline projects as well, most notably the proposed Mackenzie Valley pipeline.

⁶⁸ Prepared by Paul W. Parfomak, Specialist in Energy and Infrastructure Policy; Resources, Science, and Industry Division.

Background and Analysis

Arctic Alaska has substantial natural gas resources. The U.S. Geological Survey (USGS) estimates that conventional natural gas reserves on Alaska's North Slope potentially exceed 100 trillion cubic feet (Tcf), over four times the total annual gas consumption of the United States. The agency's assessment of undiscovered conventional gas resources across the entire Arctic region concluded that over 1,600 Tcf of additional natural reserves gas remains to be found, with a significant share located under U.S. territory. The USGS also estimates that the North Slope, specifically, may contain up to 158 Tcf of technically recoverable natural gas in the form of methane hydrates. Taken together, these vast natural gas resources—both proven and anticipated—in Arctic Alaska have been the motivation for a natural gas pipeline to supply Alaskan natural gas to the lower-48 states.

In 2004, Congress passed the Alaska Natural Gas Pipeline Act (P.L. 108-324, Div. C), a key step in advancing the pipeline project. Among its main provisions, P.L. 108-324 clarified that the Federal Energy Regulatory Commission (FERC) could accept, review, and act upon applications for a new Alaska pipeline project; provided for a pipeline development loan guarantee of as much as \$18 billion; and established guidance for FERC to regulate the pipeline's capacity bidding process so that it would be available to parties beyond the three major North Slope producers. The American Jobs Creation Act of 2004 (P.L. 108-357 § 706) provided a seven-year cost-of-investment recovery period for tax purposes (instead of the previously allowed 15-year period) and a designated economic life (class life) of 22 years for the Alaska natural gas pipeline. In June 2006, in accordance with Executive Order 3212, fifteen federal agencies signed a memorandum of understanding seeking to ensure early coordination and compliance with deadlines and procedures established by relevant agencies in support of the pipeline's development.

In 2007, Alaska passed the Alaska Gasline Inducement Act (AGIA), laying out a process to encourage expedited construction of a natural gas pipeline from Alaska's North Slope to gas markets in Alaska and the lower-48 states and providing up to \$500 million in matching funds, thereby reducing the developer's financial risks. Following passage of the AGIA, developers have advanced two major competing proposals for an Alaska natural gas pipeline:

- **TransCanada Pipelines Ltd. (TransCanada)** and Foothills Pipe Lines, Ltd., have proposed a pipeline under the AGIA process that would connect with the existing TransCanada Alberta network at the Alberta hub. The original capacity of this pipeline would be between 4.5 to 5.0 billion cubic feet per day (Bcf/d). According to FERC staff, it would be expandable to 5.9 Bcf/d through the use of greater compression only, and, therefore, at relatively low added cost. ExxonMobil, one of the three major Prudhoe Bay natural gas producers, joined with TransCanada in June 2009 to develop this project. The developers reportedly anticipate project costs between \$32 billion and \$41 billion (2009 dollars) with an in-service date of 2020.
- **BP and Conoco Phillips (Denali)**, two of the three major Prudhoe Bay natural gas producers, have proposed a 4.0 Bcf/d pipeline project outside the AGIA process (and, thus, ineligible for the \$500 million in state funds). The BP-Conoco Phillips "Denali" Pipeline would follow a route similar to that of the TransCanada project to the Alberta hub. The developers' most recent cost estimate for the project is \$35 billion (2009 dollars) with initial service in 2020.

An Alaska natural gas pipeline project has important implications for Alaska's economy. By one estimate the net present value of state and local government earnings from such a project could exceed \$29 billion over its lifetime. New natural gas royalty revenue could offset future declines in ongoing oil royalties from mature North Slope oil fields, which have accounted for 85% of the state's unrestricted general fund, on average, since 1977. Development of an Alaska natural gas pipeline to the lower-48 states would also create many new jobs throughout the nation in support of, or resulting from, the pipeline's construction.

Coincident with U.S. promotion of an Alaska pipeline, the Canadian government has been interested in developing an all-Canadian Arctic natural gas pipeline to U.S. markets. The main proposal has been a new pipeline from the Mackenzie River Delta to the existing natural gas pipeline network in Alberta. Initially, developers also proposed transporting Alaska's North Slope gas through a spur pipeline connecting to the proposed Mackenzie pipeline, but the Alaskan connection was rejected by a Canadian government inquiry report in 1974, three years before President Carter also rejected this option. The current configuration of a stand-alone pipeline to Alberta is similar in design to the Alaska gas pipeline proposals, albeit smaller in capacity (1.2 Bcfd) and lower in cost (\$15 billion) with a projected in-service date of 2016.

Status of the Issue

The TransCanada and Denali pipelines are proceeding along similar tracks. Both have initiated FERC's open season process, soliciting commitments for future gas shipments. If the open seasons yield sufficient interest from gas shippers, either the Denali or TransCanada project could file pipeline siting applications with FERC, Canada's National Energy Board, and other agencies. The TransCanada and Denali pipeline projects are competing and mutually exclusive proposals, each backed by different North Slope producers. To reduce project costs and improve the likelihood of success, some key policy makers have been encouraging all the producers to come together on a single pipeline project. To date, the projects are continuing independently, but producer cooperation on a single pipeline is a possibility.

Because the Mackenzie Valley pipeline would commercialize a major new source of Canadian natural gas, and would draw on a limited pool of construction resources and materials available for such a project, it has been viewed by some as a direct competitor to an Alaska gas pipeline. Other analysts anticipate that large increases in North American natural gas demand over the next decade will support development of both pipeline projects, and that sufficient construction materials will become available when they are needed. They view the Alaska and Mackenzie Valley pipeline projects as complementary rather than competitive. Canada's National Energy Board heard final arguments regarding the Mackenzie pipeline's siting application in April 2010, and reportedly plans to render a decision as to whether the project will be allowed to proceed in September 2010. Notwithstanding recent development progress for all three Arctic natural gas pipeline proposals, whether any will proceed ultimately depends upon the projects' economic viability, especially in light of low natural gas prices stemming from increased shale gas production throughout North America.

Questions

1. How likely is Canada to make a decision approving the Mackenzie pipeline?

2. Will the Canadian project time the construction to minimize competition between the U.S. and Canadian projects for inputs such as labor and steel?
3. If developers decide to proceed with an Alaska natural gas pipeline project, how effective will cooperation be with Canadian authorities for the Canadian section of the pipeline?
4. With recent changes in the long term lower-48 natural gas supply outlook due to new shale gas development, under what market conditions might Arctic natural gas supplies be competitive?
5. To what extent might the partly competing natural gas pipelines, once completed, diminish the economic viability of each other?
6. What percentage of the gas delivered by the Mackenzie pipeline is likely to be used by the Canadian oil sands development, and therefore, not become available to U.S. markets?
7. How might the development of Arctic gas influence future LNG imports to North America (and vice versa)?

Great Lakes Restoration⁶⁹

Issue Definition

The Great Lakes are recognized by many as an international natural resource that has been significantly altered over the last two centuries. In response, the federal governments of the United States and Canada, and the state and provincial governments in the Great Lakes basin have implemented several restoration activities. After several years of restoration activities, some contend that efforts are not progressing and are loosely organized. Some specific concerns include the slow rate of cleaning up toxic sediments in this ecosystem, and lack of governance and a comprehensive plan to address restoration of the Great Lakes.

Background and Analysis

The Great Lakes watershed is the largest system of fresh surface water in the world. The watershed covers approximately 300,000 square miles and is shared by eight U.S. states (Illinois, Indiana, Michigan, Minnesota, New York, Ohio, Pennsylvania, and Wisconsin) and one Canadian province (Ontario). The Great Lakes contain nearly 90% of the surface freshwater of the United States and 20% of the surface freshwater of the world. An estimated 40 million people rely on the Great Lakes basin to provide jobs, drinking water, and recreation, among other things. In the last several decades, agricultural activity throughout the basin, and urban and industrial development concentrated along the shoreline, have degraded water quality in the Great Lakes, posing potential threats to the ecosystem. Development has also led to changes in terrestrial and aquatic habitats, the introduction of non-native species, the contamination of sediments, and the listing of more than 50 threatened or endangered species in the basin.

⁶⁹ Prepared by Pervaze Sheikh, Analyst Natural Resources Policy, Resources, Science, and Industry Division.

The Great Lakes Restoration Initiative

The Great Lakes Restoration Initiative (GLRI) aims to restore and maintain the chemical, physical and biological integrity of the Great Lakes Basin Ecosystem. The GLRI began in 2010 and received \$475 million for FY2010 budget. The planning, structure, projects, and programs of the Initiative are based on the work of the Great Lakes Interagency Task Force (Task Force) and other agreements that address restoration. The Initiative will be directing funding to the following focus areas:

- Toxic substances and Areas of Concern;
- Invasive species;
- Nearshore health and nonpoint source pollution;
- Habitat and wildlife protection and restoration; and
- Accountability, monitoring, evaluation, communication, and partnerships.

The EPA will be the lead agency for the GLRI. The EPA has authority to transfer funds from FY2010 appropriations to federal agencies for subsequent use and distribution for Great Lakes restoration activities and projects. Some of the funds are to be competitively awarded as grants to governmental entities, nonprofit organizations, institutions, and individuals for planning, research, monitoring, outreach, and implementation of the Great Lakes Restoration Initiative and Great Lakes Water Quality Agreement. Although current EPA restoration programs and activities for the Great Lakes are included in the \$475 million, other ongoing restoration activities conducted by federal agencies are not expected to be diminished. For FY2011, the Administration has requested \$300 million for this initiative.

Under the GLRI, an Action Plan was developed. The Action Plan provides a framework for restoring the Great Lakes ecosystem from 2010 to 2014. The Task Force is responsible for ensuring the development and the implementation of the Action Plan. The GLRI is organized into five focus areas listed above. For each focus area, the Action Plan provides a problem statement, a set of goals, interim objectives, progress measures, final targets, and principal activities for restoring the ecosystem. The principal actions in the Plan are not specific projects; rather, they are broad actions that address the objectives of the focus areas. Each year, federal agencies are expected to identify specific projects they will take to implement the Action Plan.

The Great Lakes Strategy

In 2004 a federal Great Lakes Interagency Task Force was created to provide strategic direction for Great Lakes policies on restoration and to form a regional collaboration of stakeholders interested in restoring the Great Lakes ecosystem. The Great Lakes Regional Collaboration, which consists of over 1,500 stakeholders, released the Great Lakes Regional Collaboration Strategy, a plan based on implementing a series of recommendations for actions and activities to start the restoration of the Great Lakes ecosystem over the next five years. The Strategy encompasses eight issue areas: aquatic invasive species, fish and wildlife habitat (habitat/species), coastal health, contaminated sediments, nonpoint source pollution, toxic pollutants, indicators and information, and sustainable development. The total cost of implementing the Strategy is estimated to be \$20 billion over five years. The implementation of the Strategy relies on existing authorities, programs, and funding at federal, state, and local levels of government, as well as

some new actions that may require enacting new federal legislation. The Strategy as a whole is not being implemented and is being incorporated into the GLRI.

Restoring Areas of Concern the Great Lakes

The Great Lakes Legacy Act of 2002 was enacted to address sediment contamination in Areas of Concern (AOCs) within the Great Lakes ecosystem (the act was amended in 2008 to extend the authorization for appropriations through 2010). AOCs are geographical areas within the Great Lakes that represent the most degraded portions of the ecosystem. AOCs contain contaminated sediment, wastewater, and other non-point source pollution. In 1987, the United States and Canada identified 43 AOCs in the Great Lakes basin. Twenty-six AOCs are in U.S. waters, 12 in Canadian waters, and 5 shared by both countries. The act authorizes \$50 million annually in appropriations for FY2004-FY2010 for contaminated sediment remediation projects in AOCs in the United States. From FY2004-FY2009, there has been approximately \$163 million appropriated to all programs authorized under the Legacy Act, approximately half the authorized amount. However, for FY2010, the EPA “expects to provide up to approximately \$75 million” to clean up or assess contaminated sediments in the Great Lakes. The act also authorizes funding for research and development of remediation technologies, and public outreach and education about remediation. The Environmental Protection Agency (EPA) administers the selection and funding of projects authorized under the Legacy Act. Six projects are currently being evaluated, one project is underway, and four projects have been completed under the Legacy Act. One AOC has been delisted in the United States and two have been delisted in Canada.

Water Withdrawals From the Great Lakes

Several laws, policies, and governing bodies regulate the use, withdrawal, and diversion of water from the Great Lakes basin; however, the concern over domestic and international demand for Great Lakes water has prompted officials from the United States and Canada to reevaluate these laws and policies. The Council of Great Lakes Governors (CGLG)—a partnership of the governors of the eight Great Lakes states and the Canadian provincial premiers of Ontario and Québec—was tasked with creating a new common conservation standard to manage water diversions, withdrawals, and consumptive use proposals. In 2005, the CGLG released (1) the Great Lakes-St. Lawrence River Basin Sustainable Water Resources Agreement (Agreement) and (2) the Great Lakes-St. Lawrence River Basin Water Resources Compact (Compact). These water management proposals ban new and increased diversions of water outside the Great Lakes Basin with only limited, highly regulated exceptions, and establish a framework for each state and province to enact laws protecting the Basin. The Compact was approved by each state legislature and the U.S. Congress. It is now taken effect as an interstate compact. The Canadian federal government and the provinces of Ontario or Québec are not parties to the Compact; however, the provinces are signatories to the related international state-provincial Agreement.

Status of the Issue

After introducing the GLRI in 2010, several have questioned whether GLRI will maintain its level of funding for the duration of the initiative. To implement the Action Plan (from 2010 to 2014), it is estimated that GLRI will need approximately \$300 million for FY2011, and \$1.4 billion from FY2012 to FY2014. The FY2011 budget request from the Administration provides \$300 million for the Great Lakes Restoration Initiative. Congress is expected to deliberate the specifics of this request and the GLRI during the appropriations process.

To support GLRI, some have suggested creating legislation that authorizes the implementation of GLRI and its funding. Further, some others contend that restoration activities in the Great Lakes should be governed by a central entity. They argue that questions such as who is in charge, what are the federal and state roles in restoration, and how will the implementation of restoration activities be governed remain unanswered. The GLRI does not define a governing structure or decision-making process, but has EPA as the lead federal agency for implementing the initiative. Pending legislation would address these issues. S. 3073 and H.R. 4755 would authorize GLRI and implement a governance structure for managing restoration activities. In addition, both bills would reauthorize funding for cleaning up AOCs and authorize \$475 million annually from FY2011 to FY2016 to implement GLRI.

Questions

1. Given that the boundaries of the Great Lakes ecosystem extend across the United States and Canada, what major efforts are being done in Canada to restore the Great Lakes? Is Canada considering a comprehensive restoration plan that may involve binational participation?
2. Does Canada have plans for a comprehensive Great Lakes restoration strategy or plan? How can Canada collaborate with the EPA in undertaking restoration activities in the GLRI?
3. What efforts are being done to clean-up AOCs in Canada, and have they been successful? Is there scientific, technical, or programmatic collaboration between the U.S. and Canada in cleaning up AOCs shared by both countries?
4. The Compact and resulting water withdrawals could potentially affect the environment and the economies of, and relationship between, Canada and the United States. How is Canada implementing the Great Lakes Water Agreement? Are there any foreseen implementation challenges that might require binational cooperation?
5. Water quality is a concern for many in the U.S. and Canada, and is currently addressed by the Great Lakes Water Quality Agreement. The Agreement is being considered for revision by the Governments of Canada and the United States. What is the status of the review of the Agreement? Is Canada considering revisions to the Agreement?

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